For professional investors

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Cutting out the noise

INVESTMENT OPPORTUNITY
For professional Investors

September 2016

Robeco BP Global Premium Equities Fund

- Brexit shows importance of focusing on stocks not shocks
- Unloved industries may prove very attractive for value investors
- Stock selection and sector allocation will become more important

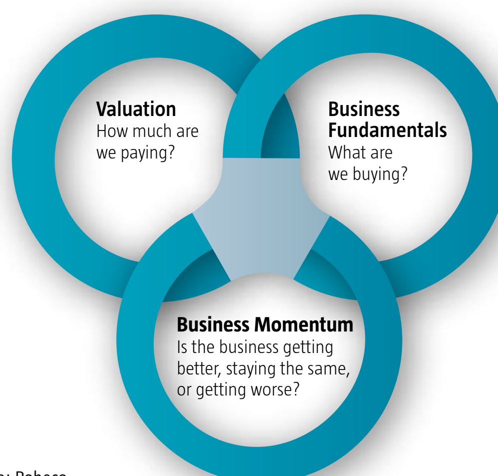
Cutting out the noise

Stock selection and the resulting sector allocation will become even more important as investors navigate growing macroeconomic noise in the later stages of the current economic cycle, say the portfolio managers of the Global Premium Equities fund, Josh Jones and Chris Hart.

The shock of the Brexit vote, concerns over Chinese growth, and commodity price fluctuations have all damped the prospects for global stocks. However, you can still find value in the market providing you stick to rigid discipline in looking for companies capable of outperforming, regardless of the economic backdrop, they say.

Boston Partners follows the tried-and-tested 'Three Circles' philosophy in pursuing only those stocks that are attractively priced relative to the market, have good business fundamentals and exhibit positive business momentum. This means it is possible to build a portfolio that can beat the benchmark regardless of whether the world is worrying about a slowdown in China or anywhere else.

Figure 1 | Three circle stock selection criteria



Source: Robeco

"Global Premium is an all-cap, bottom up product, but what investors often want to talk about is macroeconomic news and the noise in the market," says Jones, who became co-portfolio manager with the award-winning Hart in 2015, after working closely with him since 2008. "People can relate to the macro, because it's what they read about every day. But what drives the portfolio at the end of that day is finding the right businesses with the right characteristics. And what the noise often does is produce dislocations, especially in the small and mid-cap space. We consistently get asked how we outperform in up and down markets when investing in the full market cap range of companies, and that's usually because we're buying higher-quality companies, even if they're smaller ones. That flexibility has been a big advantage of the fund."

The value of value

Global Premium focuses on 'value' stocks – those that trade at share price multiples that do not reflect the company's potential. It largely ignores 'growth' or 'defensive' stocks which are often very costly when the underlying valuations are taken into account. In recent years, growing macroeconomic fears have led many equity investors to chase only momentum, believing that this would be safe territory. Subsequently, market values for growth stocks along with high yielding defensive stocks have rocketed, and they became quite expensive.

Common to all strategies managed at Boston Partners, Global Premium requires all companies in the portfolio to display attractive valuations and strong business fundamentals with positive business momentum. Always adhering to the Boston Partners 'Three Circles' investment process has led to the fund being unable to find worthy opportunities in sectors such as Consumer Staples, REITs and Utilities, as their share prices did not meet the portfolio's strict value or business fundamentals criteria. This has sometimes led to the fund significantly deviating from the MSCI World Index that serves as its reference index, sometimes to its disadvantage when momentum was the only show in town. "We won't compromise on our core principles, no matter what the short-term environment looks like; when you have a process that works over the long term, short-term results cannot alter your thinking and approach." Jones says.

"If you look at the data for the last two to three years, momentum has been the only thing that has mattered in the market," says Hart, who in 2016 was named Morningstar's European Fund Manager of the Year for its global equities category. "It didn't matter if you owned stocks that were expensive with positive momentum, or cheap with positive momentum – all that really mattered was that you owned positive momentum. Broadly speaking, if you look at value on its own without positive momentum, then it hasn't worked."

"The big dilemma that we face as value investors is that when we are in the more mature phase of the economic cycle. Considering the fact that we are seven years into it, and have so far seen a pretty good repricing of risk, we would traditionally own more defensive businesses at this stage in the cycle. But these defensive businesses are extremely expensive, so in order to effectively create a value bias in the portfolio, we have had to go into more cyclical sectors in the market, even though that is counter-intuitive for us at this point."

Unloved sectors provide opportunities

So, what to pick, given the absence of real value across much of the market? "What worked in the fund's favor last year were three 'unloved' sectors that generated most of the alpha through stock selection; energy, materials and industrials," Jones explains. "We went in and found good businesses with positive momentum in the value sector of the market. For obvious reasons, energy was a bad sector last year as the oil price was down, but there were still some good businesses that were actually doing quite well despite the weak crude oil environment. The same can be said of the chemicals and packaging companies that we owned in the materials sector, where we didn't own a lot of metals and mining companies that had been affected by the commodities slump. And there were some industrial businesses that had some very stock-specific reasons for doing well, so we bought those, and avoided those industrials businesses that had weak earnings

because they were exposed to energy, metals and mining." Jones says another good example of navigating within an expensive sector rather than being forced out of it on value grounds was the classic growth stock arena of technology. "We made some pretty good stock selection decisions in technology; we owned Google, for example, which helped a lot. Overall though, the benchmark was tough to beat last year – equal weighted indexes significantly underperformed the market cap weighted indexes in 2015. So it was a very difficult year for value managers to outperform."

With so much changing for better or worse, it is essential to create a portfolio that realistically reflects new or perceived market environments, Jones says. This is also true of the Brexit, which changed the investment landscape for many EU-reliant or sterling-sensitive stocks overnight. And while the Brexit vote came as a shock to many, the ongoing growth problems of the EU and Eurozone show no signs of abating, though the worst of the crisis that hit sentiment from 2013-2015 has passed. Subsequently, companies, industries and sometimes entire countries can be desirable one year and not the next. Jones cites five sectors that have gone into or out of favor over recent years, depending on the prevailing issue, making it important to look for stock-specific opportunities:

- **Industrials:** "We've tried to balance the portfolio characteristics in industrials and materials with some European names, i.e. away from the US in case a downturn did materialize, but there is still a quality bias in that. We particularly like some of the aerospace and defense companies, and we recently bought Siemens of Germany. We also like several business services companies in Europe.

- **Technology:** "Our tech weight has come down because we trimmed Apple pretty heavily and took our position in Google from 4% of the portfolio to just under 3%. The IT market is still bifurcated between hardware businesses, which are cheap and you just have to sort through which ones carry the most business risk, and software businesses, most of which are fine. We bought a few legacy IT businesses thus far in 2016 and also own Cap Gemini, which is more of an IT consulting business. We bought Hewlett Packard Enterprises when it split from HP; it has the services business in it which is generating a lot of cash. It has traded at only eight and a half times earnings and we think it can hold on to revenues; the market is discounting it as a shrinking business but we think there's room for margin improvement. So our tech holdings span the gamut, and are going from having more of a value tilt to more of a quality tilt."

- **Health Care:** "Our health care weight has come down because it looks fairish value to expensive now; some of Big Pharma is reasonably priced, with some noise about drug pricing reform in the US. But in a presidential election year, health care never does that well. A couple of years ago we were heavily overweight in health care, with a weighting of up to 18% when the benchmark is 13%, but now we are slightly underweight. Most of the portfolio holdings are in Big Pharma, with a few positions in health care providers. If you also look at health care equipment businesses, whether these companies are in Europe or the US, they are generally good companies with high single-digit revenue growth, low debt levels and good operating returns. They used to trade at 18 times earnings for that kind of profile, and now they trade at high 20s or low 30s; they haven't hit these multiples since 1999 or 2000. So the market is paying huge premiums for what they view as defensive, quality businesses with good balance sheets. It goes back to expensive defensives."

- **Banking:** "We have been consistently underweight in European bank credit for six or seven years, and we trimmed a lot of our US banks, largely because they would face a deteriorating credit environment in a US slowdown," he says. "Banks in Europe still look pretty messy to us: they constantly look like they're still on life support and the true issues haven't been addressed. But we do have a small position in Standard Chartered,

because although they are a bank, they have historically been a good franchise and are going through some large restructuring. We think their capital levels are fine, it's just a question of whether they can cut their cost bases so that their costs can match what's been going on with their revenues."

- **Other Areas of Finance:** "We are slightly underweight in financials generally, but we did buy a relatively large position in Berkshire Hathaway and also bought Loews Corporation, where half the value of the company is its cash. It means there is some defensiveness in the characteristics in our financials portfolio. Our favored financial position in Europe has been Aurelius, which is a German private equity company, and we have been overweight in insurance as well."

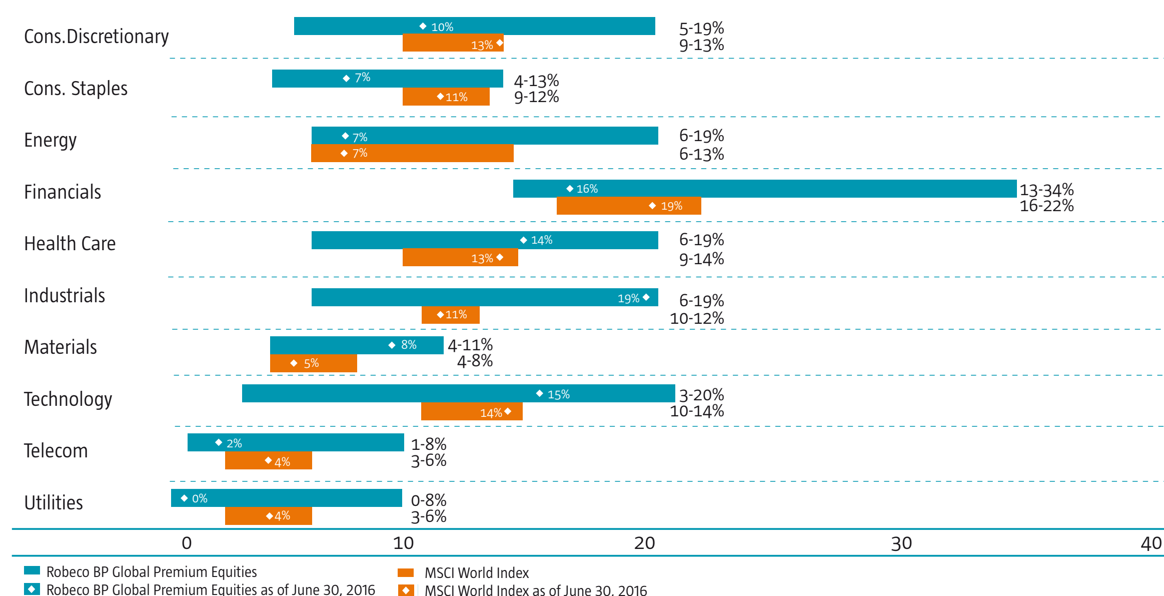
Looking for value doesn't necessarily pay dividends

One market segment that the fund tends to avoid is the 'equity income' play – those companies that pay high dividends, usually because their underlying growth prospects are restricted. High dividend-paying Utilities, for example, are highly regulated and cannot easily raise prices. Jones says this goes back to sticking to the 'Three Circles' principles and refusing to buy expensive stocks, regardless of the market trends. In fact, he sometimes prefers stocks that pay no dividends at all.

"Because we live in a low bond yield environment, equity income and dividends have been popular in the market, but generally speaking business which pay big dividends relative to their cash flow are intrinsically more expensive," Jones says. "If you look at the portfolio, the dividends that we receive are slightly below the MSCI World average. Instead, we look at a business like Berry Plastics, which doesn't pay a dividend, but is a good example of what you would ordinarily consider to be a true defensive business. It is plastics manufacturer making diapers, cups and everyday consumables that are considered staples. In the last recession they only had down revenues of 3%. It's a very cash-generative business and has a good margin profile."

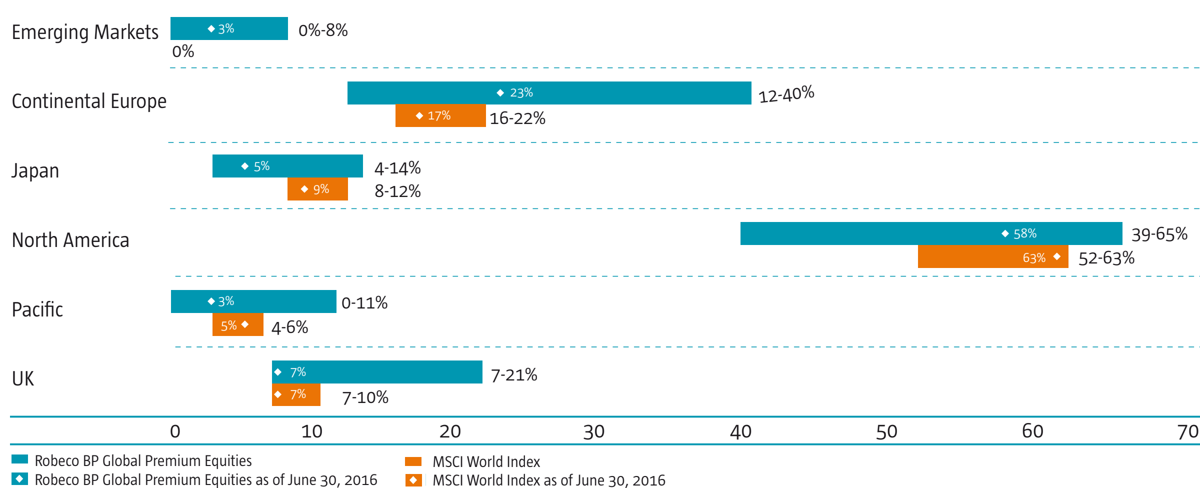
"However, the company is now highly leveraged because it just bought a large plastics business which took it from a USD 6 billion company to one with an enterprise value of USD 10 billion. Because they don't pay a dividend, don't buy back stock and now have a lot of debt due to this deal, the stock's really

Figure 2 | Sector weighting



Sector weightings in the Global Premium Equities fund compared with the benchmark at 30 June 2016. The fund goes overweight or underweight different sectors according to their relative performances at any one time.
Source: Robeco.

Figure 3 | Regional weighting



Regional weightings of the Premium Equities fund compared with the benchmark at 30 June 2016. As with sectors, various regions in the world come in and out of favor depending on their relative economic prospects
Source: Robeco.

cheap. It's has a free cash flow yield of about 15% and they're going to be using it to pay down debt, so it's almost like a public leveraged buyout situation. The market is discounting a situation like this pretty significantly and instead is putting a huge premium on businesses that are paying dividends, so this is where we are seeing the anomalies and opportunities."

Companies, not Countries

So much for sectors – what about favored regions? One segment that was seen as making a comeback in 2016 was emerging markets following years of macroeconomic-led underperformance caused by the Chinese slowdown, commodity slump and a prior strong dollar. This may now be changing, but it's still important to look at companies, not countries, Jones says. The portfolio currently owns Samsung of South Korea, and WH Group, a pork producer in Hong Kong, but does not see widespread opportunities in the emerging markets.

"At this point it doesn't make a lot of sense to start chasing the emerging markets cyclical stuff," says Jones. "We've seen a relief rally because the Fed basically backed off from rate increases in 2016 and China threw a lot of money at its economy, but I am hard pressed not to believe that the US is the best-faring economy in the world right now. The dollar has weakened, which has helped emerging markets, but eventually the Fed is going to slowly start increasing rates, and then we will go back to a strong dollar environment."

And while the Fed is tightening monetary policy as the US economy grows, central banks in the Eurozone and Japan are still engaged in monetary easing, with rate cuts and quantitative easing to try to boost their sluggish economies. "Dislocation is basically the world we have lived in for the past five years," Jones says. "We've been underweight Japan: the fact that the yen was up 13% in the first four months of 2016 neutralized the fact that the market in local terms has underperformed a lot. There are some pockets of relatively inexpensive stocks in Japan but we're wary of what's going on there: Japan remains a tricky environment because macroeconomic news is dominating the headlines. I am not a big believer that they can get out of some of their issues, so we're very cautious about the stocks that we're purchasing. We're focusing on businesses that display the Three Circles characteristics."

The yen is a case in point of how a global fund needs to largely ignore currency fluctuations and focus on the underlying companies, he says. The portfolio contains companies who report in the world's four base currencies of the US dollar, euro, Japanese yen and British pound, all of which have been up and down like yo-yos depending on the issue of the time. Sterling, for example, devalued by more than 10% against the euro after the Brexit referendum in which Britons voted to leave the European Union. "Currencies for us are pretty much business as usual," Jones says. "What we've seen over the past few years are periods where the macro really dominates the environment, but by the end of the year, business fundamentals and stock selection work themselves out, which has generally benefited us."

Life after Brexit

The Brexit vote is perhaps the best example of why it is important to rise above a large political issue and focus on stock-picking, Jones says. The fund's exposure to the UK was around 7% in the days leading up to the historic vote and our positioning remained unchanged on the day of the announcement. "There was no immediate portfolio action as we had already trimmed our UK position in the months leading up to the vote, selling a variety of consumer-related businesses," says Jones. "Our UK exposure today is still mainly consumer focused, mixed with some defense-oriented companies. This exposure is split across market capitalizations as a variety of opportunities became more attractively priced in the wake of the Brexit vote."

Banking is another case in point of how it's important to look for value rather than following the herd, Jones says. In the Brexit backlash, many investors dumped UK financial stocks as they are reliant on the free movement of capital and people across the borderless Single Market. Meanwhile, some companies threatened to leave the UK and relocate within the EU. So it's once again important to ignore the noise and focus on the underlying business cases, he says.

Josh Jones

Josh Jones, CFA, has worked with the Global Premium Equities fund since its inception in 2008. Originally a research analyst specializing in the energy, metals and mining sectors, he became assistant portfolio manager in 2013 and co-portfolio manager with Chris Hart in 2015. In addition, he is co-portfolio manager of the European Premium Equities fund, also with Hart.

Relocating from Boston, he now works in Boston Partner's London office, which closed a long-standing gap in the fund's abilities to follow all markets globally with Hart, who remains based in the US. "We basically talk daily on the portfolio, go through the new positons and the positions that we think need to be sold," he says. Having managers in two time zoneswork well, because in Boston, one of the disadvantages was that we were able to see the Asian markets open, but we never saw the Asian market close. Now I get to see the Asian close and the European open, so between the two of us we have all markets covered at all times."

So what motivates him? "I like the stimulation of coming in and picking stocks; basically I've been picking stocks since I was an economics major in college and I've always enjoyed it," he says. "The behavioral side of the market is fun, but there are highs and lows, because we're in a business where you are working with probabilities and can't always control the outcomes. So there are good days and bad days. To keep my mind fresh, I like to spend time with my family and be outdoors, so in the time I take off I like to ski, mountain bike, fly fish or golf."

"In the years leading up to the Brexit vote the strategy had an underweight exposure to European and UK banking, and this remains the case after the vote, with only one UK financial holding," he says. "In the aftermath of the Brexit vote we continue to screen for the same characteristics, in some cases identifying added valuation support but increasingly questionable business momentum. The UK holdings in the portfolio on average generate over two-thirds of their revenues from outside of the UK, which should translate to a more stable future no matter what is the end result of the UK's departure from the EU."

"For those companies threatening to relocate, we of course consider comments such as these through our fundamental research, but until a clearer picture of the business environment is laid out, this is precisely the type of noise in the market that we avoid. We would certainly expect the UK government to make efforts to retain these businesses, but predicting the final results of these discussions is not our strength or focus."

"The end result and impact of the Brexit on individual businesses is anyone's guess, and it could take several years for the dust to settle. With our investment horizon of typically one to two years, we believe it is much more beneficial to focus on the current business trade and market set-up today. If and when changes to the Single Market are enacted, our fundamental analysts would consider the impact to each individual business under consideration."

Conclusion: Let the fundamentals do the talking

In conclusion, Jones says it all boils down to sticking to our time tested Three Circles investment process and avoiding the macro noise. "If you look at the history of the fund, we struggle sometimes during these really macro-centric periods, but as people refocus back on fundamentals, it all sorts itself out," he says. "We've seen that this year when earnings came through, but it's tricky because of the overarching and often overlapping macro issues. Japan's problems, for example, put pressure on China, which has its own huge credit issues but doesn't want to devalue the yuan when it needs to because that would create a risk scenario for the whole market. Japan needs a weak currency, and so does the Eurozone, when not everyone can have a weak currency at the same time. So there's some conflicting interests and therefore we try to avoid all this noise. We try to just find businesses that are doing well and generating a lot of cash, and let the fundamentals work through."

Performance: USD D share class

	July 2016	YTD 2016	Six months	One Year	Two Years	Five Years	Since inception (08/13)
Robeco BP Global Premium Equities Fund, gross of fees	4.71%	5.46%	13.04%	0.17%	3.82%	-	8.66%
MSCI World Index (net)	4.22%	4.19%	11.58%	-0.46%	2.20%	-	6.59%

The performance figures presented above correspond to the D USD share class of the Robeco US Global Premium Equities UCITS fund launched in August 2013. The performance figures presented below correspond to the D EUR share class launched in January 2005. Performance for other share classes may vary. Performance for periods longer than one year is annualized. The value of your investments may fluctuate. Past results are no guarantee of future performance. All data to 31 July 2016.

Performance: EUR D share class

	July 2016	YTD 2016	Six months	One Year	Two Years	Five Years	Since inception (01/05)
Robeco BP Global Premium Equities Fund, gross of fees	4.02%	2.44%	9.38%	-1.03%	15.07%	16.35%	8.99%
MSCI World Index (net)	3.54%	1.91%	7.97%	-1.65%	12.88%	13.15%	6.79%

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Additional Information for investors with residence or seat in Panama

The distribution of this fund and the offering of Shares may be restricted in certain jurisdictions. The above information is for general guidance only, and it is the responsibility of any person or persons in possession of the prospectus of the fund and wishing to make application for Shares to inform themselves of, and to observe, all applicable laws and regulations of any relevant jurisdiction. Prospective applicants for Shares should inform themselves as to legal requirements also applying and any applicable exchange control regulations and applicable taxes in the countries of their respective citizenship, residence or domicile.
This document does not constitute an offer or solicitation to any person in any jurisdiction in which such offer or solicitation is not authorized or to any person to whom it would be unlawful to make such offer or solicitation.

Additional Information for investors with residence or seat in Peru

The fund has not been registered before the Superintendencia del Mercado de Valores (SMV) and are being placed by means of a private offer. SMV has not reviewed the information provided to the investor. This document is only for the exclusive use of institutional investors in Peru and is not for public distribution.

Additional Information for investors with residence or seat in Uruguay

The sale of the fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The fund must not be offered or sold to the public in Uruguay, except in circumstances which do not constitute a public offering or distribution under Uruguayan laws and regulations. The fund is not and will not be registered with the Financial Services Superintendency of the Central Bank of Uruguay. The fund corresponds to investment funds that are not investment funds regulated by Uruguayan law 16,774 dated September 27, 1996, as amended.