

# Defensive strategy hits turbulence

## Market MOVER

■ Tom Mermuys

TOM MERMUYS is the senior asset manager of KBC Asset Management (KBCAM). He spent three years as a private client manager with the firm in its home city of Brussels and started at the firm's Dublin office almost five years ago as an equity fund manager.

Mermuys oversees nearly €1 billion which is invested in 304 stocks in two funds, the KBCAM Dividend Plus Euroland Equity Fund, set up in November 2004, and the KBCAM Dividend Plus Global Equity Fund, created in June 2003. A third product, the KBCAM Dividend Plus 50/50 Fund was introduced almost a year ago to combine both funds and reduce currency risk for investors paying for the funds in euros.

### Investment philosophy

KBCAM invests in high-dividend stocks across 24 industry groups, taking a sector neutral approach to high-dividend funds.

High-dividend stocks have traditionally been seen as defensive investments because they tend to be predictable businesses in mature industry sectors such as banks and utility companies.

These businesses use cash dividends to attract investors, an enticing proposition when the markets are rough. Focusing on high-dividend stocks is one of the oldest methods of investing, according to Mermuys.

The KBCAM euroland invests across all industries in the eurozone and aims to have a dividend yield "considerably higher" than the MSCI Euroland Equity Index. Its global equivalent invests worldwide in all regions and industry groups and, equally, aims to produce a yield

"considerably higher" than the MSCI World Equity index.

Dividend yields are calculated by dividing the annual dividend per share by the share price. If a share price drops, and the dividend remains the same, the yield will rise. A company with a high dividend yield may not be able to afford to pay a dividend in the near future if earnings slump.

The funds are rebalanced every month to reflect stocks with attractive dividend yields on both indices.

"We try to judge, based on a stock behaved over the past 24 months, how the stock will behave over the next month compared to its peers," said Mermuys.

### Performance

The euroland fell by 4.3% in the fourth quarter, compared with a decline of 0.8% for the MSCI EMU Total Return Index. Between the start of the year and March 14, the fund was down 17%, said Mermuys.

After a turbulent third quarter, the global fund dropped 6.8% in the final quarter of last year, compared with a decline of 5% for the MSCI World Total Return Index. It posted a negative return in 2007 for the first full year since its inception. By March 14 of 2008, it had declined by 16% so far this year.

### Buying and selling

By the end of December, the leading stocks in the 85-share euroland fund included BNP Paribas, Daimler, Banco Santander and France Telecom. The biggest stocks in the global fund, which has shares in 257 firms, included Chevron, AT&T, Microsoft, IBM and Exxon Mobil.

The financial and real estate sectors were the worst affected in the fourth quarter. The world's biggest financial firms have so far taken \$195 billion (€124.6 billion) in writedowns on securities tied to subprime lending and the 10 biggest American banks have the lowest capital levels in at least 17 years, according to Crédit Suisse.

"Our strategy for banks is to buy the same weight as the MSCI benchmarks so, as a fund manager, I never go overweight or underweight on a stock," Mermuys said.

The KBCAM funds

also suffered from investors' reluctance to buy blue-chip stocks that yield high dividends, amid concern about slower earnings. Instead, they sought out growth stocks, which typically pay low dividends.

"The main concern I have with the high-dividend strategy is that since we launched the funds it's the first time earnings have been slowing down significantly," said Mermuys.

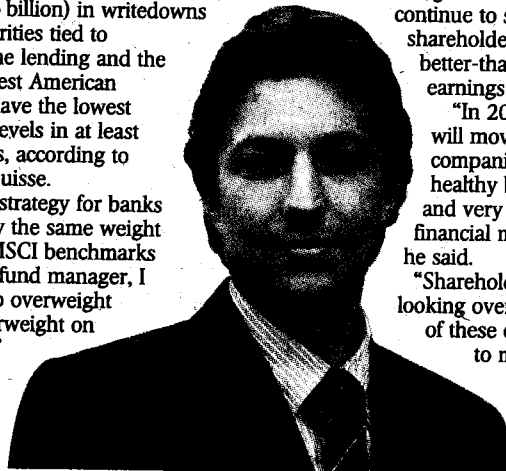
"Until last year, the companies always paid dividends or, in the worst cases, they didn't increase the dividend payment. Now firms are slowing there is a lot of pressure from shareholders to pay dividends, but the environment to do so is becoming more difficult."

### Outlook

Mermuys expects high-dividend stocks to come back into vogue this year as earnings at fast-growing companies disappoint investors and high-dividend firms continue to surprise shareholders with better-than-expected earnings.

"In 2008, the focus will move towards companies with strong, healthy balance sheets and very disciplined financial management," he said.

"Shareholders will be looking over the shoulders of these operations to make sure they pay a good dividend."



Gabrielle Monaghan

Mermuys: sees swing back to high-dividend stocks