Investments

Neil Woodford: the continuing fallout of a scandal

The writer of a new book argues that the fallen star manager highlighted some harsh lessons for the fund industry to learn

Owen Walker 3 HOURS AGO

It is more than 18 months since the implosion of Neil Woodford's business sparked the biggest British investment scandal for a decade. Yet for his former customers, the wounds are still raw.

More than 300,000 individuals who entrusted their hard-earned savings to the famed stockpicker are still waiting to recoup the money. Many have had to delay retirement after nursing tens of thousands of pounds of losses.

Meanwhile, the Financial Conduct Authority, the industry regulator, is under pressure from politicians and consumer advocates to conclude a long-awaited investigation into the affair. Law firms representing thousands of alleged victims are gearing up to take the matter to court.

While the fallout from the Woodford scandal has yet to deliver a satisfactory conclusion for his former investors, there are plenty of lessons that can be learned from what has transpired so far, many of which I explore in my new book, *Built On A Lie: The Rise and Fall of Neil Woodford and the Fate of Middle England's Money*.

The scandal shines a harsh light on a wide range of industry players — from Woodford and his business associates, to the advisers and intermediaries who convinced their clients to invest with him, the fund supermarkets that promoted his products, and, ultimately, the FCA itself.

For retail investors, a lot comes down to investment basics — choosing a fund manager, avoiding the seductive appeal of glamorous names, and checking carefully on fundamentals such as financial performance, liquidity and transparency.

The Woodford drama came to a head in June 2019 when he was forced to suspend trading in his £3.7bn flagship Equity Income fund after failing to cope with a surge of investors reclaiming their cash. Those trapped inside have since watched powerlessly as the value of their savings has diminished. They stand to lose up to £1bn — more than a quarter of the fund's value at suspension.

Woodford — once lauded as "the man who can't stop making money" and "Britain's Warren Buffett" — closed his business a few months later. It appeared to be an ignoble end to one of the investment industry's most celebrated careers.

Given the lack of closure in the affair, it is curious that Woodford last month announced his comeback — in an interview with the Sunday Telegraph. His revelation that he planned to launch a new business based in Jersey surprised the Crown Dependency's financial regulator, who told the FT that Woodford had yet to apply for authorisation and should not use the island as a "back door" to restart his career.

Woodford, who declined to comment for this article, has recently opened offices in the "most flamboyant house" in the Buckinghamshire town of Marlow, according to the local preservation society. But despite the palatial headquarters, the prospects for his new venture getting off the ground appear uncertain given the challenges he faces in finding a regulator to give him the green light.

While my book raises questions for professional fund managers, regulators and the government, it highlights key questions for investors. Not only those ruing their involvement with Woodford but also those contemplating putting money into funds, whether for the first time or the umpteenth.

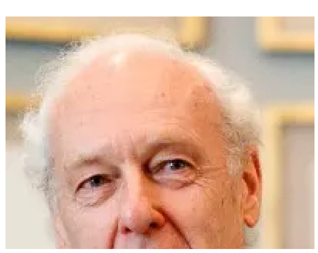
Beware the 'star manager'

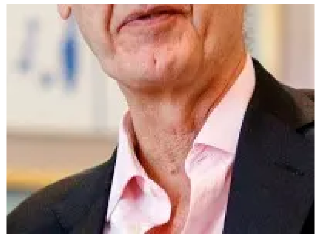
Woodford's fall from grace has drawn a line under the investment industry's star fund manager culture.

Throughout the 1980s and 1990s, investment groups competing for clients spent heavily on promoting individual fund managers. They chose professional investors whose performance records set them apart from rivals, but who would also play well in meetings with clients and in media interviews.

Soon, a cadre of elite managers emerged. Peter Lynch of Fidelity Investments and Bill Miller of Legg Mason became investing superstars in the US, while the likes of Anthony Bolton of Fidelity International dominated in the UK.

Bill Miller, former chairman and chief investment officer of Legg Mason © Bloomberg





Anthony Bolton, former manager of Fidelity’s Special Situations fund © Tolga Akmen/AFP/Getty

Marketed by their employers, they were in turn recommended by influential financial advisers to their clients. The strategy aimed to tap into the long-standing human trait of preferring to follow leaders over teams, and it worked.

The more companies fired up the profiles of these stars, the more they relied on them to attract and retain clients. As their status grew, fund managers demanded higher and higher pay, with big annual bonuses for top performers.

A cult of personality developed around the best-known managers, who lived rock star lifestyles, buying fast cars and luxury mansions.

Woodford’s 26 years working in Henley-on-Thames for Perpetual (later Invesco Perpetual) was a textbook case of the rise of the star fund manager.

Born in Berkshire in 1960, he cut his teeth in the City in the 1980s during the high-octane era of the Big Bang. But his disdain for the clubby culture of the Square Mile, which he once described as “bullshit”, led him to move to picturesque Henley in 1988.

By the early 2010s, Woodford was the UK’s most recognisable stockpicker. In his final years in Henley, PR firm Broadgate carried out a survey of brand awareness among financial advisers. In top spot came Invesco, and in second — beating well-known investment groups such as Fidelity, Jupiter, Henderson and Neptune — was Woodford himself.

So when Woodford left Invesco to set up his own business in 2014, naming it after himself was the obvious choice, especially as he and his co-founders hoped to bring along old clients. The plan worked and within a few months, Woodford Investment Management was managing more than £5bn.

Yet, as Gerry Grimstone — the UK’s investment minister and former chairman of Standard Life Aberdeen and Barclays — once cautioned, you should “never buy a fund named after someone”.

Putting Woodford's name above the door was a clear sign of who ran the business. As my book reveals, the original plan was to expand the company into a multi-strategy investment group, offering not just UK equity funds, but global equity funds, bond funds and even alternatives. The founders also hoped to provide a refuge to disaffected fund managers at other investment groups.

But by naming the business after one man, they tied the fate of the venture even more tightly to Woodford himself. Other fund managers were reluctant to join knowing they would be playing second fiddle. The whole business was reliant on Woodford's investment performance, which, despite his stellar reputation, had suffered a few knocks over the years.

On several occasions during his career Woodford's funds had significantly trailed peers — for example, during the dotcom bubble in 2000 when his portfolio suffered because of his refusal to invest in tech stocks. When the bubble was finally pricked, his fund was a big winner and his reputation as a markets soothsayer was established.

"It was the [dotcom] bubble bursting that really made Neil," recalled his former boss at Invesco Perpetual, Bob Yerbury. "Because we avoided tech stocks, we were accused of being antiquated, but what Neil is really good at is resisting the stampede. That takes a lot of balls."

The Woodford-centric business at Woodford IM also fostered a culture where anybody who stood up to Woodford and his ally Craig Newman had little future at the business.

Two of the company's founders, Nick Hamilton and Gray Smith, resigned within its first year after falling out with Woodford and Newman over the business's compliance culture and the level of due diligence carried out on Woodford's investments in private companies, according to several former WIM staff members.

Hamilton and Smith were even asked in for exit interviews at the FCA to discuss their reasons for leaving. But the regulator did not intervene in the business for another two years.

A spokesman for Woodford told the FT: "It is true that the FCA did not approach us after the interviews, and I am sure would have approached us had there been any concerns raised from the interviews."

The lack of challenge on regulatory issues was unhealthy. Woodford and Newman extracted profits from the business for themselves each year in multimillion-pound dividend payments — close to £90m over the five years the business was running — while paying staff fixed salaries. It was, in a way, the logical result of the dominance of high-profile individuals.

Stay alert for style shift

Woodford's reputation at Invesco had been forged on his investment style of selecting large, blue-chip British companies that could be relied upon to produce steady dividend payments, such as pharmaceutical and tobacco companies. Woodford trusted these businesses, which he felt were undervalued and resilient enough to withstand an economic downturn.

Savers who invested in Woodford's main fund throughout his 26 years at Invesco would have enjoyed a 25-fold increase in their initial stake. But few would have realised that below the surface, Woodford was becoming increasingly interested in investing in unlisted and small science-based companies that bore little resemblance to steady-eddie dividend payers.

Most investments that Woodford made in science-based start-ups were so small they barely registered within the £33bn he managed in total at Invesco.

But as my book reveals, during his latter years in Henley, Woodford clashed with his bosses at Invesco over these investments, with one company bringing issues to a head.

Woodford ploughed $252m into Xyleco, a US business based on a garage full of patents owned by an eccentric octogenarian with no formal scientific background. This valued the business at $3.3bn. The size of the investment and value it placed on the company alarmed Invesco bosses, who set up a committee to assess all private investments and any future commitments, according to leaked documents.

Woodford also wanted to launch a new fund at Invesco that would focus on unquoted and small listed companies, similar to the Patient Capital investment trust he would later set up, according to people familiar with the plans. But his bosses at Invesco rejected the proposal.

"The only reason to [launch the trust] was to satisfy Neil's desire," said a person close to the business. "It's his guilty pleasure to do these unquoteds, to be the big man."

Feeling his wings were being clipped, Woodford told Invesco executives in early 2013 he was leaving the business and set up Woodford Investment Management a year later.

The new venture courted retail investors, many of whom had little appetite for risky start-ups. Equity Income was designed to mimic Woodford's popular Invesco funds and prise away as many of his former followers as possible.

But as the cash poured in during the heady first couple of years, Woodford wrote scores of hefty cheques to poorly-researched private companies, whose tribulations would ultimately contribute to his collapse.

While Woodford's style drift accounts for much of his poor performance compared with his earlier record, ultimately his biggest failing was an inability to pick strong companies and hold on to them.

Woodford's stockpicking prowess had been what propelled him to stardom — but it let him down badly when running his own company. Some industry analysts had long suspected that, while he was good at making big sector calls, he struggled to identify individual performers within industries, especially start-ups.

When it came to unquoted companies, for every potential winner — such as Oxford Nanopore and Synairgen, which both played starring roles in the fight against Covid-19 — there was a stack of duds. Even in listed companies, where Woodford had long experience investing, his record in the final few years was poor.

An analysis by Stockopedia, an investment data provider, found that of the 72 companies Equity Income held in 2016, just 19 had produced a positive return by the time the fund closed in October 2019. Of these, Woodford had sold all but four. Of the 53 companies that lost value during that time, Woodford sold only 13.

He had made the classic investor mistake of keeping hold of his losers while selling his winners.

Asked about his role in the failure of his fund, Woodford told the Sunday Telegraph last month: "I'm very sorry for what I did wrong. What I was responsible for was two years of underperformance." He added that if he were running retail funds in future he would not "mingle unquoted assets in a retail fund."

But he also said: "I can't be sorry for the things I didn't do." He did not suspend or liquidate the fund, he said. "As history will now show, those decisions were incredibly damaging to investors and they were not mine."

Treat ‘best buy’ lists with scepticism

A poll of more than 800 former Woodford investors at a recent event hosted by ShareSoc, the retail investor campaign group, found just 5 per cent were persuaded to back him by independent financial advisers. The rest mostly used investment platforms, or fund supermarkets, which allow investors to select funds themselves.

These websites have proliferated in recent years as more savers search for cheaper ways to invest. But the findings show that those who were willing to pay extra for professional advice were more likely to have exited in the two years leading up to Equity Income’s suspension, when Woodford’s problems managing his fund’s liquidity levels were already known.

Of the investors surveyed, more than three-quarters had invested via Hargreaves Lansdown, the UK’s most popular fund platform with more than 1.4m users.

Part of Hargreaves’s success is down to its so-called “best-buy list”, a selection of funds it recommends to clients. Best-buy lists make investors’ lives easier as the funds they feature are touted as the cream of the crop. But such lists tread a fine line between advice and advertising.

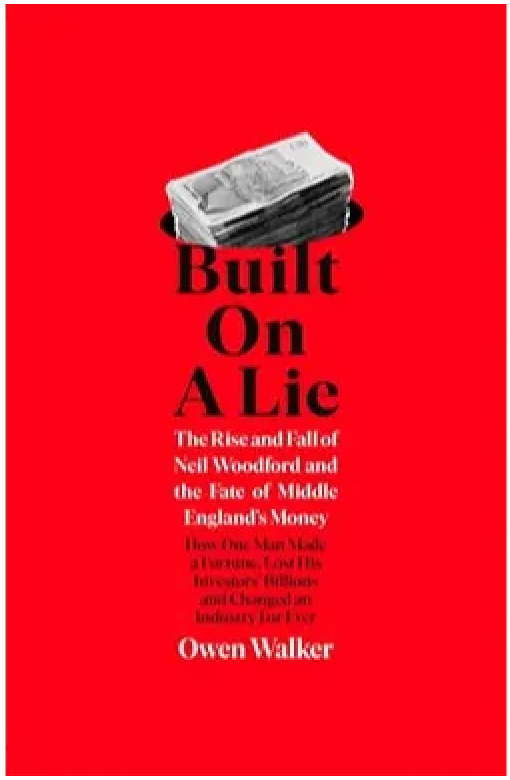
From a regulatory perspective, they are not classed as financial advice or guidance, and therefore are not monitored to the same extent. But the way the lists are promoted on the platforms often leaves customers confused about whether they are being recommended the products or not.

FT Money readers have frequently complained about the obfuscation. “[Hargreaves’] articles may say ‘this is not investment advice’, but they are written with a purpose, and the clear purpose is to encourage people like me to invest,” said one Woodford investor.

The best-buy list helped to convince Hargreaves’ army of DIY investing customers where to park their savings. Hargreaves was Woodford’s most important client, with its customers accounting for 30 per cent of assets in Woodford’s Equity Income fund and 62 per cent in the smaller Income Focus fund. Woodford IM received about £50m in fees from Hargreaves’ clients over three years.

In January 2019, Hargreaves slimmed down its best-buy list. Incredibly, despite Woodford’s poor performance for more than 18 months by this point, his two main funds survived the cull. Equity Income investors were down 17 per cent in 2018 alone.

As part of the negotiations to stay on the list, Woodford and Newman agreed to reduce their fee to 0.6 per cent, where investors on rival platforms were being charged 0.75 per cent.



Built On A Lie: The Rise and Fall of Neil Woodford and the Fate of Middle England's Money, by Owen Walker

When Hargreaves executives later revealed they had held reservations about Woodford's investments in hard-to-sell companies as early as November 2017 but kept his funds on the best buy list right up to Equity Income's suspension more than 18 months later, the platform's credibility took a battering with its customers.

Hargreaves declined to comment for this article, but has previously said the decision to keep the Woodford funds on the best-buy list was not based on the discount alone, but primarily due to its potential investment performance. It has since reformed its best-buy list.

Hargreaves' failings have also tarred best-buy lists in general. Investors who relied on what they believed to be carefully-researched lists of the funds with potential to outperform the market were shocked to discover that the selections were sometimes based more on the level of discount the fund manager offered.

Owen Walker's 'Built on a Lie: The Rise and Fall of Neil Woodford and the Fate of Middle England's Money' is published by Penguin and is on sale now