



**PETRA** – a proprietary investment process developed by Tellsons Investors LLP for analysing risk and return comparisons between different types of securities across corporate capital structures and between different asset classes – a single, integrated, fundamentally-driven framework we use to drive our quest for complementary risk-adjusted total returns with less volatility than equities.

*Important risk warning: the information and opinions expressed here are solely the opinions of Tellsons Investors LLP and should not be construed as advice nor form the basis of any investment decision. They are intended merely as illustrations of concepts Tellsons believe to be central to their investment process but should not be taken as detailed explanations or validations of that process.*

**Introduction:** Tellsons Investors launched the Endeavour Fund privately in October 2012 and publicly as the FP Tellsons Endeavour UCITS in January 2014. The fund objective is long-term growth with less volatility than equities, investing predominantly in direct individual equities and corporate bonds. At the heart of Endeavour is a fundamental, bottom-up approach to mixed asset total return investing across corporate capital structures. The core beliefs underpinning the strategy are threefold: that the aggregate of corporate activity is far more stable than the valuation swings of capital markets would imply; that this corporate activity generates *intrinsic* returns on capital employed which drives growth as well as dividend and bond interest income for capital providers; and investment in this aggregate corporate activity – what we call *endeavour* - can provide a sustainable and relatively *persistent* source of return in excess of mere capital preservation whilst reducing the often unacceptable levels of volatility associated with outright performance seeking strategies.

As well as being designed to evaluate risks and returns on one common metric between securities of different asset classes.....

**What is PETRA?** PETRA has been developed to compare and contrast all the elements of return available from various types of security that comprise a company’s capital structure. These include: bonds and other debt, where interest payments are contractual, i.e. they are legal obligations a company must meet before making any distributions to shareholders and therefore rank senior to them and are more reliable and predictable; equities, where dividends and the ongoing share in profits and growth rank below debt and are less predictable and more risky but returns are typically higher; and a range of variants or *hybrids* in between which incorporate features of both debt and equity such as convertibles, preference shares, secured and unsecured loans, where the mix of seniority and risk and return can vary. Shorter-term earnings surprise or multiple expansion are therefore not the primary elements of the PETRA investment process that you would usually expect to find in single asset strategies

.....PETRA focuses the analysis on the *probability* of total returns rather than the *possibility* of relative returns, harnessing the dependable intrinsic total returns available from capital employed.

seeking to generate returns to their specific benchmarks.

The thinking at the heart of *Endeavour* was inspired by Adam Smith’s *Wealth of Nations* where he observed the relentless, instinctive human effort to work, to improve, to provide at the heart of social wellbeing and progress.....

This is what we mean by ‘endeavour’, the intrinsic and remarkably resilient forces driving the global economy and a sound basis for commitment to long-term investment. At Tellsons we believe that return on capital employed, or ROCE, is the primary and most sustainable source of all long-term return.

‘Capital employed’ encapsulates the aggregate risk-based activity of the global economy from which all other returns are derived, to a greater or lesser extent. ROCE can be broken down into component parts available to different capital providers, in practical terms: i) contractual debt interest payments for lenders, ii) relatively consistent but subordinated dividends available to shareholders, iii) and retained earnings reinvested for growth and strength, of benefit to all. We don’t think of government bonds and cash as risk capital or *capital employed* as they are neither employed, put to work, nor at risk.....at least technically! Consequently they should be expected to return less - and generally they have, over time.

**PETRA and Total Return**

Traditionally, the different risks across corporate capital structures belong to different asset classes – equities and bonds for example - and would be analysed and valued relative to other constituents of the same asset class. The PETRA analysis uses market price and consensus earnings estimates and incorporates all the many different components of total return for



different security types before fundamental research makes a series of adjustments to determine confidence in expected outcomes.

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**PETRA** is defined as (Price divided by Earnings) divided by Total Return, and Adjusted for risk (**P/E**) / **TR - Adjusted**

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**P** = the price of a security; **E** = consensus earnings estimates for equities and contractual interest payments for bonds; **TR** = the total return from all of earnings *growth*, dividend, buyback, interest, capital gain/loss and amortisation (in local currencies); **A** = fundamental research-driven *adjustment* of a discount or premium to consensus confidence levels ~ equivalent to more or less conviction in the potential total return.

The resulting portfolio of investments is designed to yield high conviction highly active total returns with complementary risk profiles from a broader and less correlated opportunity-set than single asset class strategies: company fundamentals are pre-eminent and asset allocation is reduced to a residual of the company-specific investment case.

### Complementary Risks and Returns

Long-term returns from stocks and bonds vary considerably and are usually not very closely correlated. If all *investment* is based on the principle that capital is put to work - or placed at risk - to generate a profit and a real return after inflation (hopefully), then *savings* may be considered cash balances put at less risk, (though a bank deposit is not entirely risk free), to generate less profit and probably not much return after inflation, i.e. no risk premium for taking no risk! Different companies offer different risk profiles and so the returns vary – hence the volatility we observe in markets. And this is also true for the different parts of a company's capital structure at different times in the business cycle. Historically, since the Second World War, different data series between countries - for example, the US and the UK - suggest government bonds and cash have barely generated returns to cover the costs of inflation, each at around 3-4%, but, broadly, corporate bonds appear to have offered a total return of around 5% and equities 8% on average.

The range of these returns or volatility has varied widely in recent decades, as reflected in some measures of global corporate bond volatility at around 10% and equities at 17% over the long-term - though very much lower today after years of central bank policy intervention. Some areas of the debt markets can offer higher returns and volatility more akin to equities, a reflection of the higher levels of risk or complexity in those kind of companies' balance sheets. High yield bonds would be an example, deeply subordinated to other forms of debt and ranking closer to the equity and therefore offering

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PETRA turns the process of investing between asset classes upside down, prioritising individual company research and investment themes bottom-up across corporate capital structures rather than top-down between asset classes.

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So there are some *types* of bonds and some *times* for bonds that make highly attractive and highly complementary investments relative to equities.

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There are clearly better times for investment in stocks, early in the business cycle, for example, when earnings growth expectations are rising, whereas investment in bonds might be better later in the business cycle as interest rates are peaking and the certainties of bond income bridges the

void of a slowing economy and uncertain earnings. Investing through the 5-7 year business cycle affords the opportunity of corporate bond and equity investments yielding complementary total returns and – usually at least – risk-based returns in excess of government bonds and cash, working harder than to merely preserve capital.

### PETR-A Adjustment

To develop PETRA from our raw market PETR, our fundamental research-driven **Adjustment** covers four key areas: a) individual company growth dynamics; b) industry context and secular themes; c) management efficiency, discipline, and culture; and d) diversification characteristics between industries, countries and currencies. PETRA scores are ranked and form the basis for portfolio construction. Individual positions within Endeavour are prudently capped at an absolute 5% each. Every investment technically carries 'active' weight but is designed to drive total or intrinsic return rather than relative return or 'alpha' – after all, it is 'alpha' which is so hard to find and to rely on across markets over time.

### Conclusion

PETRA enables investment opportunities across a company's capital structure to be evaluated through one common, integrated process between asset classes from bottom up fundamental research rather than top down asset allocation. The resulting portfolio of investments is designed to yield high conviction total returns with complementary risk profiles from a broader and less correlated opportunity-set than afforded by single asset class strategies.