Breeding Capital

FT REPORT – WHY NOT BACK A RACING CERT?

By Matthew Vincent, Saturday 5th January

What is the key factor that will inform investor behaviour in 2008? Oil prices? Personal debt? Recession? No, the finest minds in the investment industry have applied their analytical skills to the question and come up with the one variable that will determine investment returns in 2008: "uncertainty".

If you read the outlook commentaries of almost every bank, broker and fund manager, it is cited more frequently than a regulatory disclaimer. "Uncertainty is the dominant theme," says the HSBC European Economics Team. "An environment of slower, more uncertain growth," is forecast by Barclays Wealth. "Uncertainty prevails," opines Citi Private Bank. "Under- estimated uncertainties" will spark a "crisis of confidence," prophesies Max King of Investec. Even Clem Chambers, the perennial über-bull of website ADVFN, reckons: "Markets will be operating under a pall of uncertainty." Richard Hunter, of Hargreaves Lansdown, suggests: "The more adventurous investor may be using these uncertain times as a buying opportunity." But what does our own "Adventurous Investor", David Stevenson, think? "The only real certainty at the moment is that the markets are deeply uncertain." Brilliant.

To be fair, he does venture a remedy for all this vagueness (see Page 7), as do some of his fellow commentators. Barclays Wealth finds reasons to be moderately overweight in equities. Others prefer asset classes with lower volatilities and correlations. London & Capital seems certain that the outlook for government bonds is positive. ETF Securities points out that "in times of uncertainty, commodities... tend to be uncorrelated to markets." And the World Gold Council suggests that the record gold price achieved this week has "resonated with investors during this time of financial uncertainty", and is "more firmly based than in 1980".

Even so, no alternative investment can be said to be a racing certainty in 2008 - except perhaps one, which is being offered to private investors this month. Breeding Capital, a company that operates a portfolio of bloodstock assets, is raising funds for two new companies whose shares will be eligible for the tax-efficient Enterprise Investment Scheme (EIS). And unlike conventional fund managers' portfolios, these companies will hold assets whose performance is already known: broodmares that have been in foal to, or are related to, winning racehorses.

Breeding Capital's strategy is to buy proven broodmares to produce foals, as well as buying other foals and yearlings, which can be resold at a profit. This provides the potential for capital appreciation and a four-legged income stream. As with all investment management businesses, the secret is to identify valuation anomalies. So while City youngbloods pore over balance sheets, the bloodstock firm assesses age, form, pedigree and - in a very literal sense - track record. This approach has seen it invest 170,000 guineas in Madura - half-sister to Manduro, the highest-rated racehorse in the world in 2007 - which was sold for 710,000 guineas 12 months later. As a result, investors in the first Breeding Capital shares have seen the net asset value of their holdings increase by 60 per cent, including EIS relief, since March 2006.

Of course, while correlations with equity markets may be low, the risk factors are numerous - injury, illness and death, on top of market and regulatory risk. But as the rest of the investment industry frets about exciting times in equity markets, this is a way to invest in Exciting Times at Newmarket... and she's the mother of Gorella, who finished third in the 2005 Breeders Cup Mile.