Opinion **Personal Finance Advice & Comment**

Neil Woodford broke the ground rules – now investors will pay the price

Is the fallen 'star' fund manager a victim? Hardly. He's made a fortune in recent years

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There are rules in fund management. You learn them pretty early in your career. They aren't complicated, but they are important.

Don't take on too much money, particularly in small-caps. Don't think it's all about you. Don't mix or dramatically change styles. Don't own too many illiquid stocks. Don't overtrade.

You can, of course, break these rules — all good stock market stories come with a maverick. But that simply makes the last rule the most important: if you break the rules, don't mess it up. Because almost all bad stock market stories also come with a maverick who messed it up.

And so to Neil Woodford. In 2014 he branched out from a much-feted career at Invesco to launch a new company with the backing of his supporters at Hargreaves Lansdown, the UK's biggest investment platform company, and St James's Place. The hype was huge. Mr Woodford launched an investment trust, Patient Capital, with the idea of investing in small and exciting companies to hold for the long term, an Equity Income Fund, an Income Focus Fund and a super snazzy website with lots of stuff about him on it ("widely regarded as one of the finest investors of his generation", etc, etc).

The trust aimed to raise £500m at launch. It raised £800m. The share price instantly went to a double-digit premium (despite being mostly cash). The Equity Income fund took in something in the region of £10bn, with clients of Hargreaves Lansdown among the most enthusiastic of buyers. How everyone loved Neil.

They don't love him any more. Patient Capital is trading close to its lowest price ever (77p against a launch price of 100p and on a discount of 14 per cent to its stated net asset value per share). The Equity Income Fund is down to a mere £3.7bn — a number it is only hanging on to by refusing to let anyone else take their money out. The fund is now suspended.

So what brought "one of the finest investors of his generation" down to earth? Breaking every single one of the basic rules. Mr Woodford took too much money too fast. He believed his own hype, forgetting that the team around him at Invesco and in particular its risk management and compliance controls might have been helping him out.

But, worst of all, he both mixed and changed styles. He may well be brilliant at long-term value and income investing. The market has been tough for this kind of investor in the past, but it has usually come good (this is a cycle Mr Woodford has been through before). It might take longer this time around, since the growth of the passive industry could be delaying the usual mean reversion, but it will still happen.

So, had he stuck to his knitting, Mr Woodford might have found that after a few uncomfortable years he was once again known as Britain's finest. He hasn't stuck to it. Instead — and this is the style change bit — he reinvented himself as a small-cap and unquoted company investor.

This must have sounded fabulous at the bandwagon-jumping business development meetings. We know that public markets are stagnating — the number of listed companies in the US has fallen by 50 per cent since 1997 — and that the real growth is now considered to be off market.

But we also know, so far at least, that this is not where Neil Woodford's skills lie. We have, as far as I know, no broken-out performance record for his dabbling in it at Invesco and his many choices since 2015 have not exactly covered him in glory. Investing in private companies might be fashionable at the moment but it is also a very specialist and not particularly transparent business — one in which other people have an awful lot more experience than him. Mr Woodford's website promises "Expertise. Reinvented." Maybe we didn't need the reinvented bit.

But style change is not the worst of his sins. Patient Capital is a long-term vehicle explicitly designed to hold the kind of hard-to-sell assets that may or may not come good 10 years out. If a couple of the firm's punts turn out to be genuine winners it might work.

I'm not a buyer of it at its current discount levels simply because it is hard to have the faintest idea what the real net asset value is. Valuing illiquid unquoted companies falls somewhere between being an art and a fantasy. Maybe we should look again when the discount hits 30 per cent (it is currently around 24 per cent). The Income Focus Fund, which could represent a memory of the old Woodford, may also come good.

The Equity Income Fund is a different matter. It should not, as its name suggests, contain anything other than solid income-producing stocks or, as the website has it, "quality companies that can deliver sustainable dividend growth". Instead, Mr Woodford has chucked much of his cool unquoted stuff in here too, hence breaking two rules at once: don't mix styles and don't hold too many assets you can't sell in a hurry.

The key point is that it is not the poor performance itself that has led to the fund suspension: it is the lousy mix of bad fund structuring, style drift and inadequate risk management. He holds too many small illiquid companies (and thanks to the raising of too much money, too much of each one) to be able to sell at a reasonable price when redemptions come in and therefore to meet the regulatory requirements around his fund structure. Big mistake — a reputation and business-destroying mistake, even.

There's one more rule I want to mention. Don't overcharge — or at least don't be seen to overcharge. These days, the best managers cut and cut again, making a song and dance of it as they do so.

If Mr Woodford was really hoping to hang on to any remnants of his reputation as a champion of the retail investors whose cash is currently locked in his failing fund, he would announce that the fees are to be slashed to zero at least until he hits a high water mark — particularly given the £36.5m dividend paid last year to Woodford Capital, controlled by him and his business partner. He hasn't.

A lot of people will tell you that Neil Woodford has been a victim. A victim of exchange traded funds. A victim of a growth-obsessed market. A victim of Brexit. A victim of overly prescriptive regulation. A victim of cynical platform promotions. A victim of amateur investor panic. A victim of the media. But either way, he is a very rich victim indeed. And that is what sticks in the throat most about this sorry saga of mission creep, arrogance and ego. Someone's made a huge pile of money since 2014. You were told it could be you. It's actually been Neil Woodford.

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