

# It can pay to go slow with the flow

Recognised for its expertise in long-term emerging markets funds, First State was nonetheless relieved to see slower inflows this year as it sought to protect investors, writes Will Jackson.

**FIRST STATE INVESTMENTS** is part of the asset management arm of the Commonwealth Bank of Australia. First State and Colonial First State Global Asset Management combined manage £95 billion globally for investors.

While most fund companies went into 2011 aiming to expand their assets under management, First State Investments was hoping for a slowdown. Rising appetite for emerging markets exposure had allowed the group to generate net retail sales of over £1.4 billion and £1.9 billion in 2009 and 2010 respectively, according to the Pridham Report, making it one of the five biggest-selling British managers in both years.

Gary Withers, First State's regional managing director for Europe, the Middle East and Africa, says some products were approaching capacity as a result. He welcomed the broad global rotation out of emerging markets and into developed market equities towards the end of 2010, which gathered pace in response to political turmoil in the Middle East and the Japanese earthquake in the opening months of this year.

"To a certain extent, it was a relief," Withers says. "We were getting concerned about the level of valuations in emerging markets towards the second half [of 2010], and we were quite public about that.

"A lot of the good news was in the price. So it was no surprise to us when the markets turned. When that happened – and we're really only talking about a three or four-month period – we saw a slowing-up of inflows.

"There was a small amount of outflow, but nothing dramatic. People have been rebalancing their portfolios and the smartest had taken some of their assets off the table in advance of the turn in the markets. But these are long-term investors and I would fully expect those assets to flow back to us when valuations are more tempting and the sense of global risk is lower – I do not necessarily see that as lost money."

Withers says large inflows do not suit First State's management style, which aims to invest in high-quality companies for the long term. The firm shut its Asia Pacific and emerging markets strategies to institutional money over a year ago. It also soft-closed two flagship Oeics – Asia Pacific and Global Emerging Markets – to retail investors, by increasing the initial and annual management fees to 4% and 1.75% respectively.

"We are trying to slow-up our flows to make certain that we manage the asset base we have appropriately," he says. "I

would not be looking to grow my Asia Pac/emerging market business aggressively from here."

Withers adds that the firm will consider closing more products to retail money to protect its existing client base if inflows pick up significantly. However, he acknowledges that such measures can cause "enormous disruption" to investors and should be used sparingly.

Despite the soft closures of the Asia Pacific and Global Emerging Markets Oeics, retail investors wanting to access First State's capability in these regions can still buy the large cap-focused "Leaders" portfolios. These funds, launched in 2003, have significantly outgrown their all-cap forebears, with assets approaching £5.5 billion in Asia Pacific Leaders and £2 billion in Global Emerging Markets Leaders.

Shauna Bevan, a collectives investment manager at Charles Stanley, says she recommends funds managed by Angus Tulloch's Asia Pacific and emerging markets team "almost by default", despite her initial scepticism on the Leaders concept. "Some years ago I said that I was circumspect, because [First State] had a mid-cap bias and when they reached capacity they launched the Leaders funds," she says.

"But I've completely changed my mind. They have maintained a strong track record in the large-cap space and in the mid-cap space."

The Leaders portfolios marginally underperformed their all-cap counterparts over the past three years, according to Morningstar data (see table), but all four funds comfortably outpaced their sectors. Bevan also holds Global Emerging Markets Leaders in the £18m IM Matterley International Growth Portfolio fund she runs with Robert Gofton-Salmond.

Tom Becket, the chief investment officer at PSigma Investment Management, says PSigma has had exposure to First State's Asia Pacific products since it was founded. He says: "First State have got a good reputation, and for good reason. They've done what they said they were going to do, and that is to deliver good long-term performance but dampen down some of the volatility in their strategies."

However, what has impressed Becket the most in recent years is First State's strategy to diversify its business away

## FIRST STATE INVESTMENTS' FUND RETURNS OVER ONE AND THREE YEARS

UK Registered Investment Funds First State Investment Mgmt (UK)	8/4/10				8/4/08				IMA Sector
	% Chg	Rank	Qrtl	Mean	% Chg	Rank	Qrtl	Mean	
<b>First State Asia Pac Sustainability</b>	14.43	11/75	1	10.67	52.08	8/68	1	38.12	Asia Pacific excl Japan
<b>First State Asia Pacific</b>	12.55	20/75	2	10.67	45.41	17/68	1	38.12	Asia Pacific excl Japan
<b>First State Asia Pacific Leaders</b>	12.42	27/75	2	10.67	43.49	19/68	2	38.12	Asia Pacific excl Japan
<b>First State Asian Property Sec</b>	3.29	33/40	4	6.5	-1.27	14/36	2	-8.33	Property
<b>First State Gbl Emg Mkts Sustblty</b>	17.84	1/46	1	9.29	N/A	----	----	32.96	Global Emerging Mrkts
<b>First State Global Emrg Mkts Ldrs</b>	13.29	5/46	1	9.29	53.71	6/35	1	32.96	Global Emerging Mrkts
<b>First State Global Emerging Mkts</b>	14.11	3/46	1	9.29	56.1	5/35	1	32.96	Global Emerging Mrkts
<b>First State Global Growth</b>	1.95	193/212	4	7.01	4.18	164/189	4	15.08	Global
<b>First State Global Listed Infra</b>	7.06	85/212	2	7.01	14.64	103/189	3	15.08	Global
<b>First State Global Opportunities</b>	3.39	178/212	4	7.01	9.56	137/189	3	15.08	Global
<b>First State Global Property Sec</b>	12.48	6/40	1	6.5	15.35	3/36	1	-8.33	Property
<b>First State Global Resources</b>	23.22	2/212	1	7.01	33.08	13/189	1	15.08	Global
<b>First State Greater China Growth</b>	10.59	6/27	1	4.73	50.01	4/19	1	43.38	China/Greater China
<b>First State Indian Subcontinent</b>	11.49	38/138	2	8.96	74.91	3/108	1	23.4	Specialist
<b>First State Latin America</b>	19.72	18/138	1	8.96	N/A	----	----	23.4	Specialist

Shows percentage returns, bid-bid, position in sector, quartile ranking, and sector average return, over one and three years to April 8, 2011.

Source: Morningstar

from Asian and emerging markets equities into “niche” asset classes. Withers says he aims to expand this side of the range at the rate of one or two products a year. The most recent addition to the line-up was the launch of Global Agribusiness last May. The portfolio, an onshore Oeic version of an offshore product run for retail and institutional investors, is managed by Renzo Casarotto and Skye Macpherson and held £25m in assets under management at the end of March.

“It is a product we developed for the Australian market and which we launched worldwide,” Withers explains. “We have seen a good take-up – it is a niche area and therefore I think it is a fund that will grow steadily. It will be attractive mainly to people with highly-diversified portfolios and professional wealth managers looking for specific exposure in these sorts of areas for particular clients.”

Bevan says she first met Macpherson last August and began recommending the fund more actively when it hit £20m in assets at the end of 2010. Bevan was due to meet Casarotto, who was visiting Britain from Australia, last week. “It’s great that they sit within a dedicated resources team rather than a more generalist global equities team,” says Bevan. “It means they understand the supply-side/ demand-side mechanics better. I have a good degree of comfort with the managers, and I think the fund will grow.”

PSigma recently cut its agricultural commodities exposure, but Becket says a colleague in Western Australia recommended the fund after visiting First State’s resources team in Sydney. “Typically, we would only have two funds from the same house,” he adds. “But with a house like First State, which has specialist investments we can’t get elsewhere, we might be more inclined to have a few positions with them. My colleague said we should review it again if we get more positive on agriculture.”

Becket is using other specialist First State products, however.

PSigma has maintained a £10m position in the £1 billion Global Resources fund since 2004 by regularly top-slicing the allocation to crystallise gains. The firm also began allocating to Global Listed Infrastructure two years ago as a satellite holding for clients requiring income.

Withers says the £240m infrastructure portfolio, run by Peter Meany, has attracted significant attention in Britain. “We expect some capital growth because there is an opportunity to invest in infrastructure in some of the growing economies, but a good portion of the return is income. It is a mixture of mature assets which are generating income, and interesting development assets where there are good returns from laying down infrastructure for expanding economies.”

First State has also seen considerable growth in its

institutional unlisted infrastructure product. Withers says the Luxembourg-domiciled fund operates an ungeared buy-and-hold strategy, taking an active role in the companies in which it invests and paying out dividends. Clients, including insurance companies and family offices, typically invest €50m (£45m), and assets under management have reached just under €500m. Withers expects the fund to approach €1 billion over the next two to three years.

The next step in the firm’s strategy to broaden its retail offering will centre on fixed income. When Fund Strategy last profiled First State, in April 2010, Withers highlighted its fixed interest capabilities in Australia. Plans to bring that expertise to a British audience have taken longer than expected, he says, but the area is still “very much under consideration”. Investors should see developments during 2011.

“We haven’t taken any firm action yet, but I would expect

to do that in the next six months,” Withers says. “Building out our investment capability remains an important part of our strategy and given the substantial growth we’ve had in our existing products, that has received more focus. I have the support of my parent company to do that, and it is about finding the right people and the right areas in which we want to make that investment.”

Expansion of the fixed-income range would require the firm to use a combination of existing resources and hiring “outside talent”, he adds.

In line with the company’s focus on niche areas and emerging markets, product launches could include emerging market debt, Asian bond or high-yield funds.

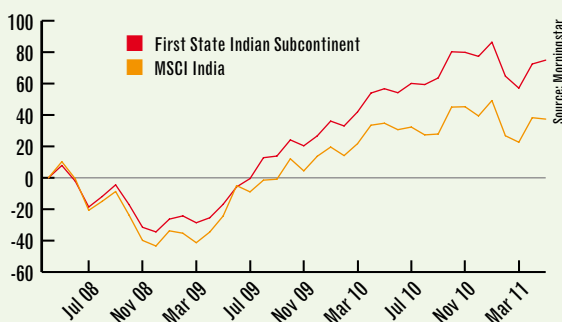
Both Bevan and Becket are broadly upbeat on the prospect of First State entering the fixed income arena. Becket says: “If you can invest in emerging market debt and work closely with one of the best emerging market equity teams, who have also got a penchant for understanding the big macro themes, that can only be of benefit.”

Withers’ primary commitment this year, however, is to continued success in the established range of Asia Pacific and emerging market strategies.

“We are widely recognised as being one of the best, if not the best, [long-term] investors in those regions,” he says. “[My first priority is] to manage the emerging market, Asia and China products and to do so in whatever market environment we face. At this stage you could call a scenario in which we see a resumption of flows into those assets.

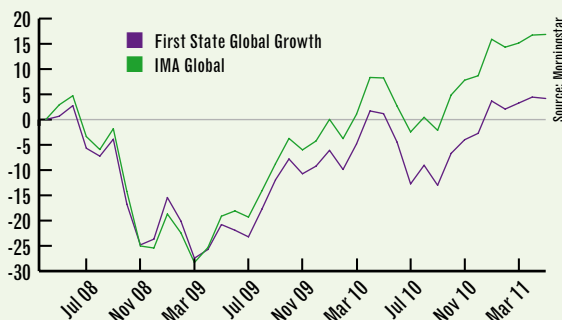
“But we could also see a world which gets quite scary, and in which people start to get very nervous. Managing the book of business we have appropriately, in what is a somewhat uncertain market at the moment, is certainly the key thing for us, because that is the bulk of our business.”

**BEST OVER THREE YEARS: FIRST STATE INDIAN SUBCONTINENT**



Shows percentage returns from the First State Indian Subcontinent fund and MSCI India index, bid-bid, over three years to April 8, 2011. Note: fund appears in the IMA Specialist sector so MSCI India used as a comparison.

**WORST OVER THREE YEARS: FIRST STATE GLOBAL GROWTH**



Shows percentage returns from the First State Global Growth fund and IMA Global sector, bid-bid, over three years to April 8, 2011.

**BEST AND WORST FUNDS**

The best and worst funds for each group profiled in the Focus are shown on a relative rather than absolute basis. The percentile ranking of a group’s funds are shown relative to their respective sectors.

“I would not be looking to grow my Asia Pac/emerging market business aggressively from here”