fundstrategy

Lots of quality, but how about value?

Key to Jonathan Asante's approach in his global emerging markets fund is finding the few stocks that represent good value amid the many run to serve a state rather than their shareholders.

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Jonathan Asante is one of those fund managers whose arguments are so lucid and compelling that after speaking to him you immediately want to invest. Unfortunately, his logic dictates that now is maybe not the best of times to pile in.

Asante, the manager of the £1.8 billion First State Global Emerging Markets Leaders fund, speaks with an authority based not just on the fund's sparkling performance figures – it's top decile over one, three and five years – but also on the company's huge depth of resources in the sector. First State has 28 investment managers working on emerging markets, based in Hong Kong, Singapore and Edinburgh and looking after $45 billion (£28 billion) in total.

The fund has returned 130% over the past five years, yet Asante says that knocking out stellar returns is not the core of First State's philosophy. More important is capital preservation. If you start from that perspective in what is the riskiest area (emerging markets) in the riskiest asset class (equities), you're not left holding the rubbish when the tide goes out.

It helps, says Asante, that the structure at First State gives him the "privilege" of having neither to benchmark against indices nor to worry too much even about extended periods of underperformance. The emerging markets team are a company within a company. Managers are expected to invest most of their personal wealth in their funds, aligning their interests with those of external investors. Crucially, profit-sharing proceeds and bonuses are paid out on the basis of three-year numbers rather than quarterly or half-yearly figures.

"It means that managers have to eat their own cooking," says Asante. The best way to beat an index, he adds, is to ignore it. "We deviate massively from the index. It means that when there are strong markets, we will lag, sometimes significantly. But when the tide goes out we do a lot better."

He points to the three-year period to 2007, when the fund underperformed "because we weren't in risky cyclical". "We are fortunate that our clients are willing to give us the benefit of the doubt. They know we are not here to chase short-term returns," he says.

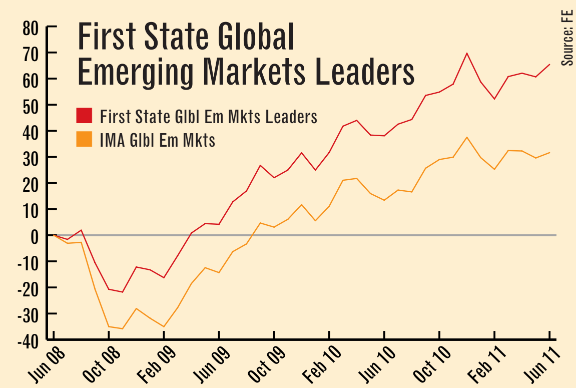
Macro-economic crystal ball gazing is not Asante's thing. "I can tell you which companies are good at navigating through problems, not when those problems might appear."

The First State approach is all about stockpicking, which in emerging markets also means scrutinising the people or families behind the firms as well as the level of state control. "There's a whole industry out there of people telling you they can forecast short-term earnings. Instead we look at the history of a company, the people behind it, what they have achieved and whether they have allowed shareholders to benefit from it. It rules out the majority of emerging market companies because so many are run for the state rather than minority shareholders."

Company accounts and balance sheets are, of course, pored over by First State's analysts, although Asante notes "the best crooks have the best accounts". Banks in emerging markets are often directed to lend to state enterprises, effectively creating non-performing loans from day one.

Asante is not just pointing the finger at the Asian nationalistic/communist model, but at Russia, where he reckons that the absence of a properly enforced rule of law makes investment difficult. The result is that First State is heavily invested in wholly private-sector companies with market capitalisations between $1.5 billion and $10 billion.

Asante raises ethical business practices in a way that other



Shows total percentage return, bid-bid, of the First State Global Emerging Markets Leaders fund and IMA Global Emerging Markets sector, over three years to June 30, 2011.

managers do not. He looks closely at health and safety in an organisation and whether it is using child labour. "If a company director is prepared to do bad things to his workforce, what do you think he is going to do to you as a shareholder?"

The fund brief means that Asante can pick emerging market stocks from across the globe, including stocks listed in the West that derive a large part of their earnings from emerging markets. But good-quality companies are not the same thing as good-value companies. He can find lots of quality emerging market stocks, but worries about how few represent value.

Overvaluations are perhaps most severe in Latin America, particularly Brazil, he says. Indeed, last December he wrote to warn investors in his Latin American portfolios that their portfolios were "fully valued". It was a good call – the Sao Paulo Bovespa index was then about 70,000 and is now about 59,000.

He still holds several stocks in Chile, but expects returns to be steady rather than spectacular. And watch out for the "ridiculously overvalued" Brazilian currency, the real, he says. The Brazilian stocks he does hold are positioned to benefit from a fall in the currency.

The fund's outperformance since 2007 has been down to astute investments in consumer staple stocks, although not the obvious Chinese names. For example, he has long been a fan of Shoprite, South Africa's biggest grocery retailer, which has begun expanding rapidly across Africa.

Uni-President, the largest food production company in Asia, is another stock that has benefited from the rise of the domestic consumer. It is based in Tainan, Taiwan, and apart from producing dairy, beverages and snacks, runs the country's 7-Eleven, Starbucks and Carrefour stores.

But everyone is piling into Asian consumer stocks. At best, Asante says, some are fairly valued, at worst massively overvalued.

So if the outlook is poor, what are all those First State managers, who have their own cash tied up in the funds, doing about their money? It's telling that they now have only about 60% in the funds, with 40% in cash (sterling, Hong Kong dollar and Singapore dollar) and gold.

"The world is a risky place," says Asante. "I would have to be sceptical of the China story. The central planners have been wonderful at balancing growth, inflation, banking and environmental concerns. I applaud them but wonder if they can keep this going forever."