SHINING A LIGHT ON..... BLACKROCK EMERGING MARKETS ABSOLUTE RETURN FUND

At a glance

For many years investors have enjoyed healthy returns from emerging markets. The story is compelling and supporters will point to strong GDP and earnings per share growth as drivers for share price appreciation.

In recent months we have seen a mass exodus from emerging markets and extreme volatility. It is now an extremely volatile unloved sector where investors are unwilling to see through the short term pain to the long term growth potential. In fact with strong returns from developed economies investors prefer to opt for these on the basis of how they have performed in recent months and their greater predictability.

For investors looking to invest in emerging markets, or already investing who are looking for a less volatile fund, then the BlackRock Emerging Markets Absolute Return Fund could be an option. Currently the fund is offshore with currency options being Sterling, US dollar or Euro.

The fund doesn't state a target return although speaking to the team they are looking to achieve between 5 to 7% with bond like volatility. It has only been operational since November 2012. 2013 was a difficult time for Emerging Markets and the fund was able to return 4.8% during this period. Therefore my feeling is that this sits perfectly either as an investment on its own or blended with a pure growth emerging market growth fund.

The review will pick up on some of the points from the manager and highlight some of the opportunity sets as well as the risks.

Who are the team behind the fund?

The fund is managed by Sam Vecht and the co-manager is Henry Wigan. Sam is head of the BlackRock Emerging Markets Specialist team. He manages the BGF Emerging Europe Fund, the BSF Emerging Markets Absolute Return Fund, the Emerging Europe Investment Trust, the Frontiers Investment Trust and the Emerging Frontiers Hedge Fund.

Henry is a member of the Emerging Markets Specialist Team. He focuses on investments in Emerging Europe, Latin America and macro strategy.

Overall Sam's performance is slightly better than his peer group over 1, 3 and 7 years. In the update with Sam he stressed the importance of the global reach of BlackRock and ability to feed this into the fund.

What is the story behind the investment?

Listening to the fund manager speak it is clear that he avoids the stories and the noise around emerging markets and clearly looks to invest in areas where he can best drive returns. I will cover some of the areas he identified under fund highlights.

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The three areas where he sees real potential are firstly around the rising real wages which have boosted emerging market consumption (along with trends such as urbanisation and better access to financial services).

Secondly economies such as China are starting to boost productivity through automation and improved management techniques.

Thirdly many economies in emerging markets have better credit reports than developed markets including the US.

If we overlay this with the prevailing dynamics around emerging markets – for example much younger and growing demographics, in Asia the average age is 30 with a population of 4 billion growing by 1.5% a year. In contrast the developed economies have a population of 1 billion growing at less than 1% a year with an average age of 45.

The debt levels of these economies are much lower than the west meaning that they have the ability to grow faster unburdened by debt and the social costs of an aging population. There are of course many more metrics we can highlight to show why investors should consider emerging markets but the downside with many of the economies is poor political and legal systems which need reform before they can move to developed status. We have seen China start to make these changes as it transforms itself towards a developed economy. Others will surely follow.

There are risks as we have seen with "hot money" flooding into weaker economies and when talk of tapering came, a sudden withdrawal by investors caused extreme volatility. The danger is that a strong dollar could weaken them further as they rely on foreign funding. Turkey saw a rapid rise in interest rates, and if others follow this could cause a snow ball effect. If these economies sell dollars to prop up their economy it will tighten domestic liquidity which in turn will damage companies.

In summary there are clear opportunity sets in emerging markets and the long term picture is bright however there are short term risks and who knows how these will play out.

Fund highlights?

Listening to the manager it is worth touching on his approach to investing to drive the positive returns. The fund manager employs a long / short equity strategy. With long positions where the manager expects stocks to increase and short is where he expects them to decline. By doing this he minimises market exposure, while profiting from stock gains in the long positions and price declines in the short positions. The idea is that together they generate a positive return whatever the market is doing.

The strategy effectively takes out a lot of the sudden rises and falls in the market to deliver smooth returns. Although the fund aims to deliver positive returns it can be negative on a short term time horizon.

Clearly the manager doesn't want to disclose where he has used a short strategy but as an example he confirmed he is short Emerging Market Financials as a group but has long positions in Garanti Bank, and Halk Bank. Another position is Industrials where there are a number of shorts and then Reliance Industries which is long. So it can be seen from these examples how the manager plays one stock against another or specific stocks long whilst shorting a sector.

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Sam briefly touched on the areas he likes which includes technology, and selective industrials. He doesn't like the consumer sector which he feels is overpriced (we can see this in his strategy with a short position in consumer staples).

Generally Sam is optimistic for emerging markets, there are low valuations and countries like India and Russia offer some excellent opportunities. Sam believes now is a good to invest because everyone is negative on emerging markets and this naturally provides opportunities. He does have concerns about cash generation from companies but careful stock picking means that he can potentially benefit from the general negative sentiment.

In summary he is positive and using his strategy he can steady the returns from a market uplift but provide a degree of protection if the uplift takes time to come through.

Fund performance

Performance since launch is shown below.

	2010	2011	2012	2013	2014	Since
						Launch
BSF Emerging Markets Absolute	-	-	-	4.84%	-1.56%	4.18% p.a.
Return Portfolio						
iShares MSCI Emerging Markets	4.43%	-20.53%	9.50%	-7.31%	-7.68%	-4.76% p.a.
(inc)						

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced. Returns are based on the US share class.

Conclusion

For investors looking for a less volatile fund to gain exposure to emerging markets this fund does offer the potential to deliver this. The sterling share class appears to be fairly new and it is difficult at this stage to ascertain whether the same levels of returns can be delivered as the US share class. The fund is not part of our portfolios and at this stage it would not probably be one we would add.

The source of information in this note has been provided by BlackRock and is correct as at January 2014. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well rise.