

SHINING A LIGHT ON..... HERMES ASIA EX JAPAN EQUITY FUND

At a glance

First State and Aberdeen have dominated the Asian and Emerging Market Retail Investment Market. The managers are now looking to limit new money coming into their funds as they have grown in assets to a level that limits investment options.

We have identified a number of talented fund managers who we can turn to as replacements. One of the funds is run by Hermes. A lesser known name which is starting to make its presence felt. Hermes is the active fund manager of the BT Pension Scheme, and recently opened up some of the funds to the retail space. They manage £25 billion of assets.

Because of the connection with the pension scheme the focus is on long term out-performance (rather than chasing short term wins). All the managers are rewarded on this basis over a three year period.

In this review we look at the Hermes Asia Ex Japan Equity Fund managed by Jonathan Pines.

Who are the team behind the fund?

The Asian Team were brought into Hermes in 2010 and the retail fund was opened in November 2012. The lead manager is Jonathan Pines. Previous to Hermes he was a fund manager at RAB Capital and Analyst at Orbis Investment Advisory as well as a partner at PKF Johannesburg and CIO at Akul Capital. His contrarian approach to investing has delivered outperformance for the strategy since it started in 2010.

The deputy manager is Samir Patel who previously worked as a portfolio manager for Polar Capital, Charlemagne and Pictet and Cie.

What is the story behind the investment?

The Asian Markets consist of 11 diverse markets which continue to grow their share of global output. In 2000, these markets represented less than 20% of GDP. This is expected to rise to 35% by 2017.

The main trends underpinning these economies are:

- **Increasing consumption:** Greater industrialisation and the emergence of an urban middle class are generating greater wealth, which in turn raises domestic consumption.
- **Strong economic fundamentals:** Many Asian economies entered the global downturn with relatively sound fiscal positions and monetary policies. This has allowed governments in the region to implement interest rate cuts and fiscal stimulus packages, thus maintaining domestic consumption levels.
- **Favourable demographics:** Young, fast-growing populations and a shift from rural areas to cities, combined with increases in national and personal income, are stimulating strong economic growth.
- **Improved corporate governance:** This has given rise to a new generation of world-class companies that are increasingly capable of delivering superior returns.

LWM Consultants Ltd

The recent volatility in the markets has seen investors move away from these economies to 'safer' developed economies. However, the fundamentals behind investing in Asia remain and long-term investors are likely to be rewarded.

Fund highlights?

Jonathan is best described as an unconstrained, contrarian, value manager.

He is seeking quality companies at an attractive price. Such companies tend to have low debt and strong cash flow but are unloved by the market. Negative sentiment forces down the price of shares which presents his type of opportunities.

As an example Cathy Pacific is a quality company in a terrible sector (airlines). At its lowest point its share price was HK 7.11 in 2009; this peaked at HK 23.10 in 2010 and is now hovering around HK 15.

Another example is Cosco Pacific; a Chinese Port Company. It is in a poor sector (shipping) and in China (unloved country). Over the last 20 years it has consistently delivered positive results but is trading significantly below its average price to book ratio.

Both are top ten holdings. The average holding period is 18 – 24 months; although he will hold longer (some stocks have been held since the strategy started in 2010). The key trigger for selling is the target price, which when reached he will sell down. This exposes a potential weakness in the strategy in that he can miss out on some additional upside by selling early. However, this approach doesn't appear to have impaired comparative performance.

There are other factors which can trigger a sell, for example with the unrest in Thailand Jonathan exited his position in a Bangkok Bank. He describes this approach as capturing the upside but also protecting the downside.

Jonathan is benchmark unconstrained (90% of the fund is outside the benchmark) and his fund is likely to be very different to his competitors. The fund currently favours small and mid-cap however the weighting towards smaller companies has declined as the fund has grown. There is no evidence that this has impacted on performance yet. The fund manager is looking to restrict flows into the fund once it reaches \$2 billion (although he believes this is some way off) to ensure he protects existing investor interest.

Hermes also offer a Global Emerging Market fund and there is a small crossover in holdings between the two however the style of the manager's is different and therefore we do not believe holding both funds is negative for investors.

In summary our view is that this is a good alternative to First State and Aberdeen. Although the fund was only launched to the retail space in 2012, the strategy has been in place since 2010 and the manager has demonstrated significant out-performance from inception.

LWM Consultants Ltd

Fund performance

The table below shows performance since launch and going into 2014:

	2012 (since 1 November)	2013	2014	Since Launch
Hermes Asia ex Japan Equity Fund	3.67%	25.85%	-1.30%	28.77%
iShares MSCI AC Far East Ex Japan	6.31%	-1.21%	-4.34%	0.47%

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.

Conclusion

Fund managers are limiting inflows, therefore enabling them to deliver performance in the way they want to. This fund does have some capacity before the manager limits new money. The manager was concerned that 2013 was a standout year. However, he has demonstrated in 2010, 2011 and 2012 (prior to the retail offering) he can outperform the benchmark and we believe that this will make a good addition to our portfolios.

The source of information in this note has been provided by Hermes and is correct as at March 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.