

## **SHINING A LIGHT ON..... HERMES GLOBAL EMERGING MARKETS 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 Global Emerging Markets Fund managed by Gary Greenberg.

### **Who are the team behind the fund?**

Gary Greenberg joined Hermes in 2010. He has over 30 years' experience in emerging markets working for Silkstone Capital, Muse Capital, GSAM, Van Eck Global, Peregrine Asset Management and Wanger Asset Management.

His deputy manager is Samir Patel who joined Hermes in 2009. He previously worked for Polar Capital, Charlemagne Capital and Pictet and Cie.

### **What is the story behind the investment?**

Frontier and emerging markets potentially offer a compelling investment case.

Asia's population of 4 billion people is growing by 1.5% a year (with an average age of 30). Africa's population of 1 billion people is growing by 2% a year (with an average age of 19). By contrast the developed world population of 1 billion people is growing by less than 1% a year (with an average age of 45).

This younger working population contributes positively to the economy; for example Brazil and India have high ratios of working age people to retired people (the bulk of India's population is under 44). In the US, for example, they do not have sufficient workers paying taxes to provide entitlement programmes for the retired.

China is pivotal to emerging markets as are India, Russia and Brazil. These economies outspend the US (which on its own accounts for 25% of the world's spending) and the gap will grow.

Average earnings in China have grown by 300% in 10 years and wealth is being distributed to a growing aspirational middle class. Growth in 2012 and 2013 was 7.7% and is expected to be 7.4% in 2014.

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Fundamental reforms are now being adopted which include private investment in state controlled industries, reversal of the one child policy, freeing up of interest rates, improving treasury yield curves and the ability for qualified private investors to set up small to medium sized banks. These reforms will take time; probably decades.

Other BRIC countries are struggling; India's economic growth fell below 5%, Brazil's growth is negative and Russia just 1.3%.

Brazil benefits from Chinese demand for natural resources. The Brazilian mining company, Vale, is the world's largest iron ore exporter and China is its biggest customer. It is one of the few countries in the world self-sufficient in oil and has the largest farmable land in the world. Brazil is becoming the world's leading sugar, coffee, beef and chicken exporter. Combined with Argentina, the two are the world's biggest soybean producers.

Resource rich economies including Qatar, UAE and Saudi Arabia have seen significant stock market rises through companies in the construction and retail sectors.

Qatar and UAE have progressed to a point where they are being upgraded from frontier to emerging status. Having invested heavily in infrastructure (reminiscent of China in the 2000s) - high speed bullet trains, airports and other new infrastructure projects have opened up the centre of the country. Qatar grew by 5% in 2013 and UAE 4%.

Saudi Arabia's economy (the largest in the Middle East) grew on average by 5.9% p.a. over the last ten years. It rose over 60% from the previous 10 year average and faster than the global average growth of 3.8% (Source: IMF).

Dubai will sponsor World Expo 2020 enhancing its position as a financial gateway between the East and the West. The economy is set to grow by 6.4% p.a. over the next three years.

Kenya and Nigeria are attractive frontier economies with the young populations, increasing consumer spending power, fast growing GDP, and low government debt. The average earnings are around \$1,300 per capita.

Nigeria is prioritising infrastructure which will open up roads and create a national electricity grid, which follows the likes of China, Qatar and UAE.

In summary, with younger, more dynamic economies which are growing emerging economies have the ability to dominate the 21<sup>st</sup> century, as the US did in the 20<sup>th</sup>.

## **Fund highlights?**

Gary took over the management of the fund in 2011, over the next two years he has incrementally introduced his style of management into the process. This has meant that a lot of the 'dead' ideas have been weeded out, and in 2013 he was able to have a portfolio which reflected his style and ethos.

For investors this may seem too early to judge as the performance prior to 2013 was mixed and didn't demonstrate any significant out-performance.

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Like the manager of the Asian Strategy Gary is a contrarian, value manager but one key difference is that he wants to see a reason for the price of a share to re-rate. A quality company can be cheap and remain cheap without a catalyst for change.

Stock picking is important (looking at corporate governance, environmental issues and social mandates) but sector and macro outlook plays a part. For example one of the holdings is China Mengniu Dairy. A number of scandals tarnished the industry however this company has adapted, is now part owned by Danone and he was impressed on a personal visit whilst in China.

The catalysts for change in the share price are fourfold – milk consumption is rising from a low base, the new management (CEO from Coke, and Danish Dairy Management) is underrated by the market, the company have delivered consistent earnings growth and have a dominant industry position.

From an environmental, social and governance viewpoint there is an improving supply chain and quality controls, the market is still overstating the concerns and steps have been taken to improve food safety. Hermes also has an Equity Ownership Services engagement team which are working with the company which gives them a fuller insight. The shares were purchased at around HKD 23 and now trade at over HKD 35.

Care has to be taken when investing in emerging economy companies. Fraud is more prevalent, he has been caught out but experience has given the team a much better nose for the fishy.

The team has qualified accountants who can look at the books, they will also use their engagement team where needed and also contacts on the ground where they don't know the management. If the view of the management is negative they won't invest even if it looks a good company. However, Gary is optimistic about investing in emerging markets.

He accepts there are dark clouds but these will drift away – Korea and Taiwan are functioning economies and Mexico is heading in the right direction. China is moving towards a market orientated economy and India have a choice to move in the right direction with the elections in May. However, Brazil and Russia still have challenges.

In summary some emerging are challenging and a number of funds will use western firms to reduce volatility, Gary believes this dilutes exposure with little benefit. Western firms do have local operations, like Unilever but Gary is more interested in the next Unilever. For example, Havells is an Indian Company which makes consumer appliances and is the type of company which he favours.

Gary provided a very honest view of his style of management, he is seeking quality companies at cheap prices but there has to be a catalyst to re-rate. Because of the nature of the markets he will employ different methods to test the proposition before investing. The only downside for investors is whether he can deliver long term outperformance following the restructuring of the fund.

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## Fund performance

The table below shows performance since 2009 and going into 2014:

	2009	2010	2011	2012	2013	2014	Since Launch
Hermes Global Emerging Markets Fund	60.81%	17.68%	-17.88%	8.27%	7.91%	-6.12%	85.27%
iShares MSCI Emerging Markets (Inc)	54.30%	21.85%	-20.53%	9.50%	-7.31%	-5.79%	53.15%

*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

This fund is unlikely to stand out for many investors looking at longer term performance. If investors consider that the fund had been restructured and 2013 was the first year of the new manager then clearly he has been able to navigate a very tricky period. 2014 has been weak however we believe over the long term this manager has the potential to deliver strong outperformance and we would be looking to add this 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.*