

SHINING A LIGHT ON..... FIRST STATE ASIA PACIFIC LEADERS FUND

At a glance

First State has dominated the Asia Pacific Investment Market alongside Aberdeen for many years. However, the fund now stands at over £5 billion and the managers have indicated recently that they may limit future money into the fund to protect existing investors.

Currently the fund is still open, and with recent poor performance from the region over the last two years it is likely that the managers have not closed the fund simply because investors have naturally moved money away.

The fund has a good performance track record and is well respected in the market. Since 2009 it has outperformed the index in all but one year. There are a number of reasons why investors would opt for this fund over other Asian Funds and in our latest update with the investment team we will highlight some of these.

Who are the team behind the fund?

Angus Tulloch is the lead manager of the fund and has a huge amount of respect within the investment arena. The co-manager was Alistair Thompson who has recently been replaced with Richard Jones.

There doesn't appear to be any reason for the removal of Alistair Thompson who has been the co-manager for 10 years however it is something for investors to consider. Angus Tulloch is a significant part of the team and should he leave it may leave the fund vulnerable depending on how much influence he now has over the fund. This is not clear and the firm are very keen to emphasis the wider team rather than the individuals.

What is the story behind the investment?

The Asian Markets consist of a number of 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.

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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?

First State have put a lot of resource behind the fund, the team is 31 strong with specialists feeding in across the different regions which includes China and India. In the latest update we heard from the managers of the China and Indian Funds who ultimately supply ideas across to the manager of the fund.

Many of the alternative options have much smaller teams and this could go against them.

The First State Fund is possibly best described as a boring fund. This is not a negative, and could be a good reason to invest. They believe strongly that their aim is to preserve and grow client's capital with a 3 to 5 year time horizon. Their interests are therefore aligned to client interests with members of the team investing in the funds and all incentives based on 3 to 5 year performance.

Some managers are judged on 12 month performance and therefore there can be a danger that the strategy is lost as they chase short term gain. This can bring more volatility to the portfolio with little benefit.

In 2013 and 2014 to date although the returns are level they have managed to preserve client capital whereas the index would have lost capital. In 2011 when the markets tumbled the fund was negative but index was down nearly twice as much.

For a large fund there would be concerns that there would be too many holdings and no conviction. However, the number of holdings are around 55 which seems low for this type of fund and the top ten holdings make up around 40% of the fund so there is plenty of conviction. However, it does provide a clue to the market they are looking at which is large and mega cap stocks.

They acknowledged that the stocks in the top ten are expensive and that this could be a challenge for the fund going forward. To tackle this they are looking at new generation companies however my concern is that these companies are likely to be relatively small and therefore realistically how much can the fund hold of that business and can it realistically make a difference.

On the asset allocation the manager indicated they were underweight China, holding around 7%. However, we noticed that they significantly overweight Hong Kong. This is important because many Chinese companies are listed on this exchange and therefore we would question whether they are really underweight (i.e. still Chinese companies but listed elsewhere).

They have avoided Indonesia with no exposure and are overweight in India. We discussed China and India at some length because these are the power houses in the region.

China has challenges – the area we discussed was around changing labour patterns. China is seeing labour costs increase making products more expensive and average wages above the likes of Thailand but below Singapore, Korea and Japan. To become more efficient they need more innovation. Currently around 27% of manufacturing is automated, the same level as Japan in 1988. Japan now sits at 84% and the challenge is how they achieve this.

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The types of companies they are seeking at those which have strong R&D budgets. The other area which is growing is Patent applications which are increasing significantly where regions like Korea have declined. Effectively this is the new China they are looking to invest in.

India is equally in a difficult place, they have seen two years of declining truck sales, car sales and below 5% GDP growth. These are at the lowest levels they have seen compared to the past and valuations are cheap. Whereas China has to show that it can deal with the changes they believe India is already starting to change and therefore they have invested the fund more heavily in this region.

Regionally the fund is more diversified than some Asian Funds investing in the region and the focus on large to mega is positive for investors prepared to play the long game. A concern for investors is that if the stocks are expensive then will this restrict growth especially when the market corrects, and although they have indicated a desire to find companies investing in new technology will such a large fund be able to do this in such a way that benefits the investor. For those looking at regular investments it may be a concern that they may close the fund in the future although even smaller funds have indicated their intention to limit inflows which could be a challenge.

In summary for those investing in Asia over the long term and wanting solid large cap investing this fund may be the best opportunity but they need to consider whether some of the stocks are overpriced and whether this could have a negative impact going forward.

Fund performance

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

	2009	2010	2011	2012	2013	2014
First State Asia Pacific Leaders Fund	34.99%	26.80%	-7.90%	18.60%	0.43%	2.26%
iShares MSCI AC Far East Ex Japan	33.27%	24.93%	-16.58%	14.03%	-1.21%	-3.70%

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

The managers may limit flows into the fund to protect performance and investors should be aware of this before investing. Over the medium to long term it has demonstrated strong performance although there is concern that if stocks are overvalued whether it can continue to do this going forward.

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