

SHINING A LIGHT ON..... GAM STAR NORTH OF SOUTH EM EQUITY FUND

At a glance

Emerging markets have been one of the strongest sectors in 2014. Often the likes of First State and Aberdeen are associated with these markets however there are a growing breed of 'new' managers coming into the market who run much smaller and more dynamic and liquid assets.

We are constantly searching for these managers to identify potential 'star quality'. Many of these funds tend to be offshore which means that they are not always available to investors. One of the funds we recently found was the GAM Star North of South EM Equity Fund.

Initially I was put off because of the number of holdings (just over 100) and a feeling of no conviction to one stock (average weightings in top ten are between 1.5% and 3%). The fund had a feel that at best it would track the index.

Listening to the manager I didn't initially get a strong sense of how he approached investing however as I started to research further it became clearer what the manager was looking to achieve and how this fund might be attractive to investors. More importantly for investors since launch it has significantly outperformed the index.

With this in mind I wanted to try and highlight some of the key points of how the manager approaches investing and highlight some of the approaches he explained in our discussion.

Who are the team behind the fund?

The fund is managed by North of South Capital, a boutique investment management firm that has been specialising in emerging markets since it was founded in 2004. The lead manager is Matthew Linsey who has managed global emerging market equity funds for over 19 years at companies including Deutsche Asset Management, Baring Asset Management and ING Asset Management.

Fund highlights?

Matthew has run the fund since its launch in 2011.

Much of the notes in this update are taken from the discussion and then overlaid with the additional research we did. One of the first discussions was what makes the fund stand out.

Matthew started by explaining that there were three ways to add value. Firstly market timing (which he pointed out was really hard to do), secondly via asset allocation and thirdly stock selection.

For him the two areas where he can add value are via asset allocation and stock selection. The two are interlinked in his view because he is looking for market inefficiencies and mispricing and this is how the fund stands out from the crowd.

Taking this one step further we discussed asset allocation which is really a focus on macro picture. A key element of the investment process is looking at how the market is viewing events and interpreting them. Matthew then looks at data to identify whether the share prices of these

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economies are reflecting what the market is thinking. Effectively what he is trying to find are market inefficiencies, and therefore can he exploit these.

Blended with this is stock selection. Matthew was quick to emphasise that he is keen to avoid index companies because these tend to be focused on 'state' run enterprises which can be inefficient. This means if the index is down then in theory the companies he chooses won't follow the same path.

He describes himself as a value investor and looks for those companies that have little debt, provide a dividend yield and have cash. On the flipside he avoids companies with too much debt even if they are growing the top-line because effectively any growth is being eroded by debt repayments.

Therefore to achieve outperformance and be different you need to blend the macro picture via asset allocation with good stock picking and this is clearly where he believes the fund stands out.

The fund is multi-cap with over 100 stocks with no one stock dominating the portfolio which means that it provides some 'protection' against losses whilst still capturing the upside. This approach clearly works as the fund has significantly outperformed the sector.

Turning to how he approaches investing we took the example of two economies - Colombia and Argentina. The shale gas revolution is starting to impact emerging markets. Colombia has the potential to be the 4th largest shale gas producer and its valuations are half of the US, Argentina could be the 2nd largest producer with valuations of a third. He admits that Argentina is a wild card but this is where there is potential value. Therefore his focus is on finding good companies which will thrive in this environment and it demonstrates the focus on looking outside of the box to find opportunities and long term value.

This fund struck me as well managed with a focus on 'protecting' on the downside without compromising on the upside. The management of the fund is outsourced to a third party which does make the fund slightly more expensive and there is a performance fee. However, these additional costs have not impacted on the performance.

The blend of macro (asset allocation) and stock picking is clearly where the managers feel they can add value. Certainly in the discussions we had there was little that we could find that was negative about the fund. Two small things for investors to consider, firstly this is a third party manager and should they terminate the contract then what will happen next and secondly this is an offshore fund and therefore may not be available to all investors. It is also worth considering that North of South offer an Emerging Markets Hedge Fund and investors might want to compare the performance, style and costs with this fund.

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Fund performance

The table below shows performance since 2011 and going into 2014:

	2011*	2012	2013	2014	Since Launch
GAM Star North of South EM Equity Fund	4.74%	20.59%	6.66%	12.84%	15.48% p.a.
iShares MSCI Emerging Markets (Inc)	6.29%	9.50%	-7.31%	7.45%	53.15%

*launch 3 October 2011

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 is a well-managed fund with an excellent track record. It doesn't feel that the managers take undue risk to achieve that performance and in fact the focus on companies without excess debt and free cash flow supports the aim of protecting on the downside whilst benefiting on the upside. The only question mark is around the use of a third party firm which has its own funds and whether performance might be better direct with the company.

The source of information in this note has been provided by GAM Star North of South and is correct as at September 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.