

IN THE SPOTLIGHT

First State Investments' Habib Subjally talks to Cherry Reynard about screening for potential winners

When taking a singular point of view works



Funds in the IMA Global Growth sector are often an amalgamation of a series of global portfolios. Analysts in Hong Kong or New York feed ideas to a manager who collates this research and decides the 'best' 50 stocks.

Habib Subjally takes a different approach, believing a true comparison between recommendations from different global analysts is at best unwieldy and, at worst, impossible. His First State Global Opportunities fund is built as a standalone product from the research of the group's 11-strong fund management team in London.

At the end of their process, the group wants to be able to make three distinct judgements on a stock. Is it cheap? Is there a catalyst for change? And what is its downside risk? The valuation judgement is not as simple as looking at a price/earnings ratio. Mr Subjally points out that a stock on 8x earnings is not cheap if earnings are halving.

He says: "Stocks are mispriced because the market loves or hates them. We like controversy: if there is no controversy there is no mispricing. But cheap is not enough – stocks can stay cheap for a long time – so we need a catalyst. This is something that will cause value to be realised within 12 months."

Finally, the judgement on risk looks at what could happen if analysis is wrong. What is the potential downside? With every worldwide stock a potential investment for the fund, however, Mr Subjally must whittle down his stock list to get a working number of stocks to research.

He says: "I have worked for companies where they have 50-60 analysts from around the world all submitting ideas. It's like crowd control. It's difficult to compare the ideas of a telcos analyst in Brazil with a consumer analyst in New York."

The group starts with a number of screens. It is not interested in illiquid securities, so all companies in the portfolio will have a market capitalisation of \$2bn (£1.3bn) or above.

Mr Subjally also excludes many emerging markets.

He says: "The return often depends on who owns the company – the interests of the family or their political ambitions. Analysing this requires a different set of skills, so we only invest in advanced emerging markets such as Israel, Korea and Taiwan that are high quality in terms of disclosure and corporate governance."

Even after these screens, 3,000 companies remain. A quantitative screen excludes companies that are unlikely to meet the criteria for inclusion.

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Mr Subjally says: "From there, it is a question of going to meet the companies. Every month, we aim to generate 40-50 new investment ideas to research. We visit the management and talk to their competitors and suppliers."

He describes himself as – philosophically – a stock picker rather than an asset allocator, preferring to spend time looking at companies, visiting factories, shops or analysing cash flow and balance sheets, rather than forecasting the dollar versus the yen, the oil price or whether small cap will outperform large cap.

Yet that doesn't mean he ignores asset allocation. He recognises if small cap or Japan aren't working, it can add to or detract from performance, adding: "We try and minimise its influence by being diversified across all sectors and regions and with no structural bias to value or growth."

He sees it as taking 50 small bets on individual stocks rather than betting the house on, say, the oil price.

Performance has been strong; the fund currently lies 16th out of 131 funds in the sector over five years and 43rd out of 159 funds over three years.

Mr Subjally says: "Investment per-

formance is always lumpy. If you analyse the past three years, performance has come reasonably evenly across sectors and regions. It hasn't been dominated by getting one sector right. It is most difficult for us to outperform when there is a major macro shock in the market. As such, the last 18 months have been difficult. The market has been more interested in big strategic issues."

He does think this will change, however. "The past 18 months have been so macro dominated and it has all been about who has exposure to financials or junk bonds. Now it is the sovereign issue – who will fall apart out of Greece, Portugal or Ireland. But lately, we have been seeing a lot of stocks that are mispriced relative to one another."

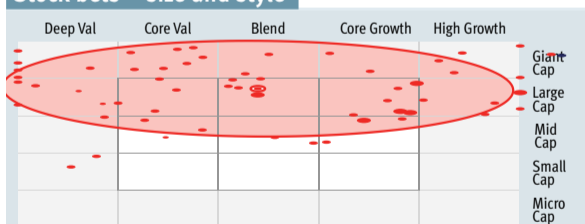
These stocks may have seen a similar performance over the last couple of years, but one may have significantly better fundamentals or improved management. He believes the market will start to discriminate, and these changes will be reflected in stock prices as soon as there is more stability in the market.

He adds that 'problem' areas such as Spain and Greece have thrown up opportunities. The market has been simplistic in its approach – in general, anything exposed to emerging markets has gone up, and anything exposed to autos has gone down.

Or, as Mr Subjally says, "over the long term, businesses that are dull, well managed, re-investing in their businesses with superior technology and customer service will outperform. This is not being recognised at the moment, but that is the opportunity".

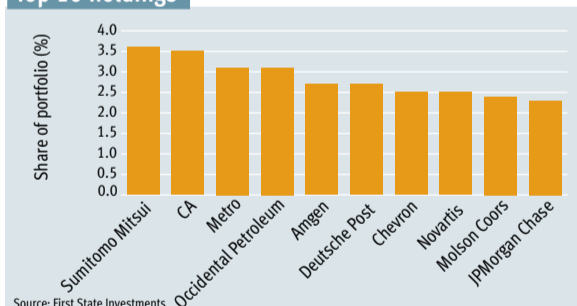
Walgreen is an example of this in the portfolio. A 'venerable old retainer' of a drugstore company in the US, it did extremely well until the mid-1990s, after which it underperformed its peer group significantly. It was viewed as a dull laggard with little growth potential. It is now going through a redevelopment process – widening aisles, improving its product range, better labelling and lighting – and Mr Subjally sees it as a good self-help story.

Stock bets – size and style



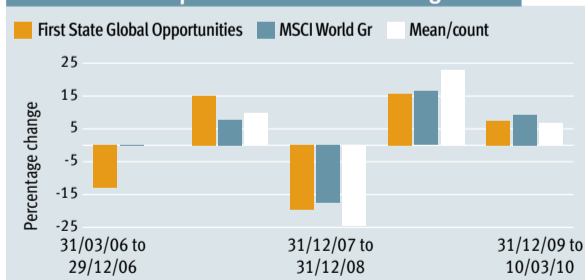
Note: the chart shows the historical trajectory of the manager's holdings-based style. The largest dot represents the latest date. Source: Morningstar

Top 10 holdings



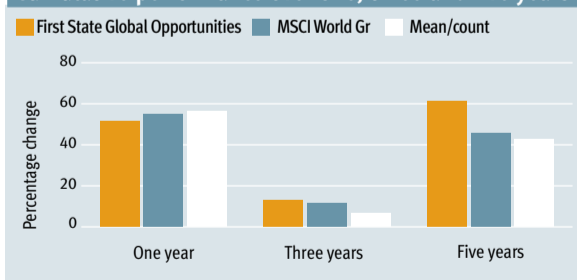
Source: First State Investments

Discrete annual performance since manager start



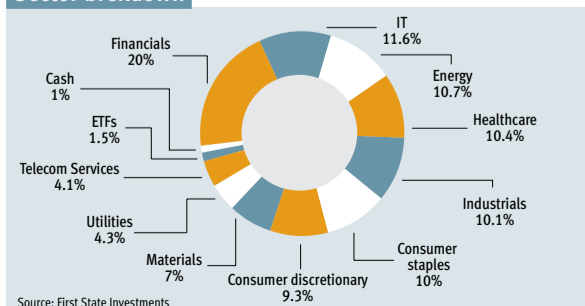
Source: Morningstar

Cumulative performance over one, three and five years



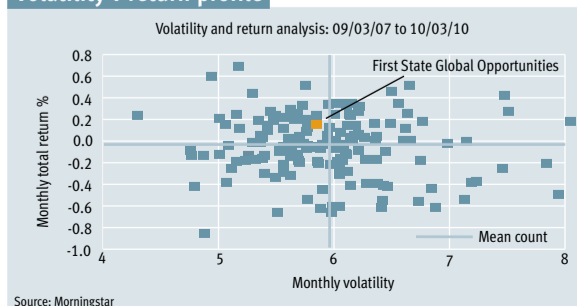
Source: Morningstar

Sector breakdown



Source: First State Investments

Volatility v return profile



Source: Morningstar

fund footprint

Launch date: 08/99

Manager start date: 04/06

Previous manager: Andrew Dalrymple

Fund size: £40m

Number of holdings: 61

Benchmark: MSCI World index

Information ratio: 0.01

Sharpe ratio: -0.03

Tracking error: 2.41

Volatility: 5.85

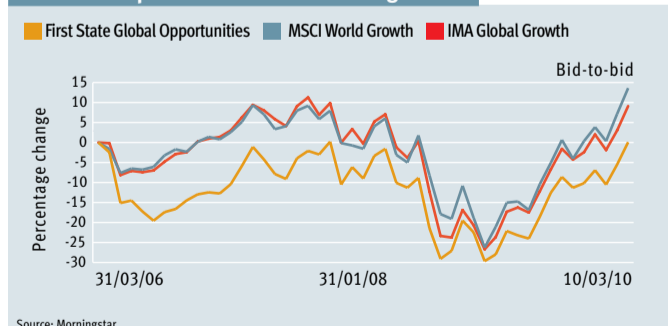
TER: 1.78 per cent (share class A) at December 2009

Turnover: 263 per cent

Source: Morningstar/First State Investments

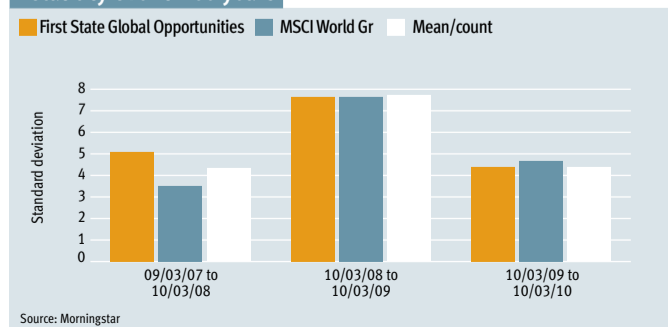
Note: Mean/count contains fund survivor bias. IMA sector (index) is an average of fund data over six weeks, including funds since liquidated

Cumulative performance since manager start



Source: Morningstar

Volatility over three years



Source: Morningstar