

RADAR ALERT – FIRST STATE LATIN AMERICA

Asante and Mathieson say Brazil is 'over-cooked' while Chile looks attractively valued

First State's Asante finds ideas amid risky markets

By Barney Hatt

Latin American funds have outperformed over the past year, driven by low valuations and growth opportunities in the region, with the 10 Latin American funds within the IMA Specialist sector up 58.5% over 12 months to 21 June.

Launched in April 2009, First State's Latin America fund is up 55% over the same period, compared to an IMA Specialist sector average of 31.8%, according to Morningstar.

Managers Jonathan Asante and Millar Mathieson are part of an Asia Pacific emerging markets team based in Edinburgh, Hong Kong and Singapore.

Asante says the Latin American fund is run in the same way as all the firm's Asia Pacific and emerging market funds.

The managers invest their own money in the fund, and do not start with the MSCI EM Latin America benchmark index as a basis for constructing the portfolio.

Asante says this is particularly important in Latin America because the benchmark index is skewed towards a couple of large stocks – the Brazilian companies Petrobras and Vale – neither of which he owns.

The point is highlighted by the portfolio's top 10 holdings, which account for over 40% of the fund, while, according to Asante, the equivalent weighting in the index is about 2%.

He believes First State Latin America deviates in a significant way from its peer groups because the managers are not tracking an index. Although, he admits, "we have to beat the index in the medium term to stop being sacked by our clients."

Asante adds: "We think the best way to do this is to ignore it

as a basis for the portfolios.

"There are hardly any Latin America funds that do not have Petrobras or Vale in them, but we do not like them as investments.

"If we do not like a company we do not own it – we would not have, for example, a 2% underweight position."

The managers take a three- to five-year view when making an investment.

"We are not trying to forecast the future because we think this is rather a difficult thing to do," Asante says.

"Instead we look at the history of companies and find people we can trust to deliver and who can give some of this delivery back to shareholders."

The manager says these are not always the same thing.

"You can find fantastic entrepreneurs in emerging markets and Latin America," he says.

"People do spectacularly well but will find ways to take the returns away from you ultimately.

So we are looking for people who can deliver and share this delivery with us.

"We do not talk to them about quarterly earnings. We talk to them about their attitude to risk, and things which will indicate what their ethics are."

The First State managers are part of a large bank – the Commonwealth Bank of Australia – but operate as a semi-independent entity within the bank.

Asante explains: "We have a legal agreement, which means we essentially, as an investment team, run our business.

"We have strict limits on capacity. Our Latin America strategy is only allowed to have \$200m because we want to buy the smallest companies sometimes."

Performance has been driven by a few large positions in some

small- and mid-cap names which have done particularly well over the last year.

"The credit crunch was a liquidity crisis so very small companies were very out of favour, and it was clear to us there were three or four which were very cheap," Asante says.

"We were able to have lots of large positions in them because the fund was small, and they did quite well initially."

Examples of strong performers include Brazilian insurance firm SulAmérica, which was the biggest position when the fund launched, and another Brazilian stock, Duratex.

However, Asante says, almost all of the stocks have performed well because markets have gone up since the fund was launched.

Asante hates fashionable markets and believes this is particularly important in Latin America. Within the region he says Brazil in particular is "far too fashionable", and in recent months has been adding to Chilean names in place of some of the Brazilian names he feels are overvalued.

The biggest position in the fund is Inversiones Aguas, a Chilean water utility firm, accounting for 9.3% of the portfolio at 31 May.

"The Brazilian weighting continues to come down and the Chilean goes up," Asante says.

"This is not a call per se from a top-down basis: it is very much a bottom-up approach, and the valuations in Brazil are just looking too rich at the moment."

He adds: "Chile is the least risky country in Latin America and is by far our most preferred country.

"We think Brazil is very much over-cooked and over-egged. The good quality companies there are much too expensive."

However, Asante says if these companies become cheap enough he will buy them back.

"We would be very happy to buy some of these high quality names back, especially if smaller caps have a problem," he says.

TOP 10 LATIN AMERICA FUNDS	% CHG
HSBC GIF LATIN AMERICAN EQUITY	67.80
IP LATIN AMERICAN	64.31
JPM LATIN AMERICA EQUITY	62.72
THREADNEEDLE LATIN AMERICA	61.24
SCOTTISH WIDOWS LATIN AMERICA	56.69
TEMPLETON LATIN AMERICA	56.60
FIRST STATE LATIN AMERICA	56.47
BARING LATIN AMERICA	56.25
SCHRODER ISF LATIN AMERICA	52.35
NEPTUNE LATIN AMERICA	50.42
SECTOR AVERAGE	58.48

19/06/09 – 21/06/10. Source: Morningstar



JONATHAN ASANTE (LEFT)

- Has 15 years experience specialising in global emerging markets.
- Joined First State Investments' global emerging markets team as senior analyst in 2004.
- Manager of First State Global Emerging Market Leaders and Global Emerging Market Funds since 2007 and head of global emerging markets since 2008.
- Lead manager of First State Latin America fund since 2009 launch.
- Previously global emerging markets fund manager and group economist at Framlington, and assistant researcher at NatWest Group.

MILLAR MATHIESON (RIGHT)

- Joined First State's global emerging markets team in 2001.
- Co-manager of First State Latin America fund since 2009 launch.
- Deputy manager of Global Emerging Markets Sustainability and Asia Pacific Sustainability funds since 2010.

WHAT THEY SAID BEFORE

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First State's Jonathan Asante has a number of concerns about the short-term outlook for emerging markets.

"Having rallied very strongly, markets are no longer attractively valued," he says.

"Our favoured stocks in Brazil, China and India are expensive and we believe there is limited value in the global emerging market universe. We do, however, continue to find some attractively priced quality franchises in the less popular markets of Israel and South Africa."

Asante says he will continue to maintain a focus on "good-quality companies and superior stock selection."

He adds: "At one end of the quality spectrum, falling input prices and cheaper currencies will be positive for the long-term profitability of a wide range of companies in our portfolio. In a downturn, strong managements really earn their keep and create stronger franchises."

The manager remains positive on the long-term outlook for the sector as he expects economic growth to be higher than that of Western economies.

He says: "Our long-term view of economic growth should provide companies with excellent opportunities to boost sales and profits."

"Across the developing world there are an increasing number of quality companies with proven management and strong business franchises that are focused on long-term shareholder value."

"But if markets continue to go on in the way they are I would envisage we will be trying to find more defensive names in the likes of Chile at the expense of these valuations we are seeing in Brazil."

Asante believes it is currently a risky time to be investing in Latin America funds.

He says: "I tell people if you are going to do it and you are as concerned about losing money as making money, our fund is a good place to be because we tend to hold up when markets fall."

"But in our emerging markets fund we have as low a weighting in Latin America as we have ever had."

His objective is to find stocks which can make money on a three to five-year view and believes there are fewer and fewer of these type

of stocks in the region.

He says the other problem in Latin America, and in particular Brazil, is the region is very exposed to commodity prices.

"I do not think there is much room built into Brazilian valuations for disappointments there, coming out of China for example," he says.

"On a long-term view we are very comfortable with this fund and the prospects for the region, but at the present time valuations, especially in Brazil, are looking fully valued at best."

"Argentina reminds me of Brazil 10 years ago after the Brazilian currency went."

"You can see the differences in sizes – it is very stark – so we now have 7% or 8% of the fund in Argentina," he adds.

First State Latin America vs sector average

