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global emerging markets from a different perspective

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"Emerging Markets: Strategic allocations in Focus"

HedgeWorld.com website

"exploit inefficiencies in emerging markets"

HedgeCo.net website

CNBC TV
DowJones Newswires
EM Fixed Income Forum London
Emerging Markets Monitor
EMTA Winter Forum London
Euromoney
Euromoney Bond Congress London
European Pension News
Expansion
Financial News
Financial Times
FT Adviser
FTfm
FT Mandate
Fund Forum International Monaco
Funds Europe
Global Investor
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Hedge Fund Review
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IFR Emerging Market Conference London
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Investment & Pensions Europe
Investment Week
Latin American Investors Forum New York
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Money Marketing
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Pensions Week
Portfolio Adviser
Portfolio International
Private Equity International
Professional Adviser
Professional Pensions
Professional Wealth Management
The Alternative Investment Forum London
The Banker
The WealthNet.com
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FINANCIAL TIMES
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BOUTIQUES FTfm

Beating the dip in emerging equities

The founder of Focus Capital tells Steve Johnson about the benefit of a multi-asset approach

For an emerging market evangelist, John Cleary is surprisingly downbeat about the near-term prospects for the region's equity markets.

"Emerging market equities will struggle to generate good returns this year," says Mr Cleary, a fund management industry veteran who broke away from the pack to launch his own London-based boutique, Focus Capital, in 2006.

Some might view such pessimism as a cue to cut their exposure to the world's emerging markets. However, to Mr Cleary, it is a demonstration of the beauty of the flexible investment approach adopted by his flagship Emerging World vehicle, a fund of funds.

Mr Cleary, whose CV features roles such as chief investment officer at Standard Asset Management and head of emerging market debt at Invesco Asset Management, launched his boutique precisely because he believed a multi-asset approach was easier to adopt away from the political in-fighting of a larger house. And he is not shy of making full use of this in-built flexibility.

"Last year we had no debt whatsoever and we had 80 per cent cash at the end of February.

"Now we have switched to no equities and just debt; 50 per cent in local currency debt and the rest in debt strategies via hedge funds, leveraged funds, special situations and corporate bonds," he says.

"There is potential for economic decoupling to a far greater degree than market decoupling. Markets are suffering from negative sentiment in terms of risk appetite and emerging market equities need positive risk appetite to perform.

"I think equity return is not going to be on the table this year, but the potential for local currency return is still there. A lot of emerging markets have rampant inflation and one of the factors they can use to alleviate that is currency appreciation."

From his experience with a swathe of established asset management houses, Mr Cleary believes only smaller, more nimble boutiques can run such freewheeling funds.

"We know we are unique. The biggest obstacle [at larger houses] is that they have equity, fixed income and alternatives teams and never the twain shall meet. It's very difficult to get them to collaborate, they have different profit lines and different reporting lines. The nearest we have got is the balanced mandate ethos and that has gone out of favour."

Mr Cleary says he has recently had a series of meetings with asset allocators at banks, who have been "disappointed" with their own in-house emerging market offerings.

The Emerging World fund returned 19.2 per cent before fees in its first 13 months, to the end of March, according to data from Focus Capital, below the 22.3 per cent of the MSCI Emerging Market Free (Equity) index, but well ahead of the returns from developing world hedge funds and bonds.

However, with far lower annualised volatility than for equities, 8.2 per cent against 24.3 per cent for the MSCI index, the fund boasted a superior Sharpe ratio, a measure of return per unit of risk, of 1.9, just below its target figure.

From his vantage point of assessing fund managers across asset classes, Mr Cleary is well placed to make observations about the peccadilloes of the industry at large, and observe he has.

One, perhaps surprising, nugget stems from his search for managers who exhibit consistent outperformance. "On the equity side, by and large the biggest houses have tended to deliver that. On the fixed income side it's the smaller houses that do."

His explanation for this apparent conundrum is that large houses with significant equity assets under management have so much at stake from a poor year that they simply cannot afford to let that happen.

In addition, Mr Cleary believes equity managers "need people on the ground to visit companies". In contrast, "bond mandates are more global, therefore you don't need to be local to get as good a take on the macroeconomic factors, and arguably you can get that understanding more objectively in London or New York. We have definitely seen a trend and it has surprised us."

Mr Cleary is also dismissive of the abilities of hedge funds to play emerging market equities, hence his decision to go heavily into cash around the turn of the year, rather than hedge funds.

"We have hedge fund exposure on the debt side, but on the equities side we were scratching our heads. It's very difficult to hedge emerging markets, you can end up with an imperfect hedge. [Hedge funds] underperform on the upside and they tend to underperform on the downside, certainly in terms of volatility. We would rather be in cash."

The fund's mandate also allows it to invest in exchange traded funds, but Mr Cleary believes, at least as far as emerging markets are concerned, this sector is still work in progress.

"The ETF market is definitely improving but it is still quite narrow," he laments.

"Focus Capital to launch revolutionary EM fund

Multi-asset mix makes new Emerging World fund one of a kind"

Investment Adviser magazine