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BOUTIQUES FTfm

New-found freedom from bias and hubris

Focus Capital's John Cleary tells Steve Johnson liberty to diversify is key with emerging markets

A desire to escape the overweening ego of the typical investment professional has played its part in persuading John Cleary to go it (almost) alone after 20 years in the fund management business.

Until September, Mr Cleary was chief investment officer at Standard Asset Management, running white-labelled high yield and emerging market funds for American Express. Before that he was head of emerging market debt and global high income at Invesco Asset Management, with West Merchant Bank and SG Warburg also popping up on his CV.

But Mr Cleary has stepped out of the comfort zone to launch London-based Focus Capital, a specialist emerging markets boutique, alongside Elena Villalba, an evacuee from the Spanish division of American Express Funds.

The move came after Mr Cleary decided that the only sound way to invest in emerging markets was via a vehicle that can freely switch between bonds, equities, hedge funds and even cash, to exploit different stages of the economic cycle. Furthermore, he felt this could only be done objectively in an independent house.

"There are inherent biases in investment firms. They are generally known either for bonds or equities, there are very few worldwide that have a balance. As managers get promoted to a higher political position, if they understand bonds, say, then

that is an easier sell. It takes a lot to get over that barrier."

In addition, many in-house funds of funds are constructed largely of their own funds, whereas Mr Cleary wanted a free hand to look at all managers without a conflict of interest.

But, equally importantly, he did not want to be held hostage by the peccadilloes of individual managers. "If you have a good fund manager, you have to manage his ego, his bonus and his salary," he says. "Good managers have the tendency to believe they are invincible, that they are masters of the universe, but markets can be very humbling."

The first product, a fund of funds called Focus Capital Emerging World, is due to arrive in the first quarter of next year. It will be free to invest across the emerging market asset space, but Mr Cleary hopes, it will escape these twin terrors of bias and hubris.

"We consider equity, bond and hedge funds should all be part of emerging market investing. Diversification is the best risk management tool for this asset class.

"No one manager can outperform in all market conditions, especially in emerging markets, and when you are dealing with unpredictable markets, strategic allocations are key."

Mr Cleary will not be too proud to throw in the kitchen sink if emerging markets really hit the fan, with an allocation of 100 per

cent cash among the options if necessary.

Unsurprisingly he is bullish about the sector at present. The model portfolio, in the process of receiving seed capital, is 100 per cent invested in equities, two-fifths in Latin America and a fifth each in China, India and the eastern Europe/Middle East/Africa region.

This positioning is based both on a view that we are in an equity-friendly stage of the investment cycle, and a more fundamental faith in the emerging market story.

Although history points to a lack of correlation between economic growth and stock market performance in a given country, Mr Cleary has faith that the rapidly changing economic world order will spill over into equities.

"We believe emerging markets are currently undervalued. Emerging markets already account for more than 50 per cent of world output, 47 per cent of the world's oil consumption, 42 per cent of the world's exports, over 80 per cent of world's oil reserves and 85 per cent of the world's population. Yet these markets account for less than 15 per cent of global market capitalisation."

This manifesto lends itself to a top-down investment thesis. Mr Cleary quotes research indicating that 93 per cent of investment returns are generated by the asset allocation decision.

He will decide on asset allo-

cation, with Ms Villalba, the director of investments, concentrating on individual fund selection. "We will have worked with or against most of these managers in the past," adds Mr Cleary.

The Emerging World fund is an absolute return vehicle that will target a Sharpe ratio of between 3 and 4. Focus Capital has back-tested its model portfolio for the past three years and claims that its Sharpe ratio came out at 3.86, against 1.86 for the CSFB/Tremont Emerging Market Hedge Fund index, 1.8 for the Morgan Stanley Emerging Market Free equity index and 1.23 for the JPMorgan EMBI Global Diversified bond index.

In 1998, the fund would have risen 2.2 per cent, aided by its ability to hold cash in times of strife, while the JPMorgan bond index has fallen 8.1 per cent, the Morgan Stanley equity index has lost 27.5 per cent and the CSFB/Tremont hedge fund index has slid 37.7 per cent.

The fund will have a minimum investment of €100,000 or \$100,000 and is aimed at professional investors, private banks, distribution platforms and family offices. Charges will be up to 2 per cent annually, with a 25 per cent performance fee.

The fund will be listed on the Dublin stock exchange and domiciled in the Cayman Islands, with monthly subscriptions and quarterly redemptions.

"Emerging market boutique from ex-Invesco manager"

Investment Week magazine

"Former SAM chief Cleary launches emerging markets boutique"

Professional Pensions magazine

"New firm has Focus on emerging markets"

TheWealthNet.com website

"new independent emerging market fund of funds manager"

Private Equity International

"Focus Capital targets emerging market equities and bonds"

Financial News magazine

"Focus Capital For Emerging Markets Funds"

Dow Jones Newswires

"We believe it is possible to make absolute returns every year in emerging markets, but you need investment flexibility to allow you to take advantage of the different asset classes"

Professional Pensions magazine

"We expect more than 80 per cent of our performance to come from strategic asset allocation decisions"

FT Adviser magazine

"The choice of emerging market countries and the assets in which you invest can dramatically affect returns. Our investment process allows us to fully analyse and exploit all asset classes."

EUBankers.net website

Based on our globally unique investment approach we have appeared in the following:

**“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
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Fund Forum International Monaco
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The Alternative Investment Forum London
The Banker
The WealthNet.com
What Investment?

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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 out-performance. “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