Asia's Money Masters

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Transformational Change

Jim Rogers retired at the age of 37 but that hasn't stopped him from eyeing the next big investment opportunities. He thinks he's found more in Asia.

Jim Rogers is never shy of an opinion. "It's ironic that in "Red" China, you'll have the market playing a larger role. On the other hand, in the West, people seem to be saying that the government is smarter than the market", he says.

Jim Rogers

His words are backed with action, having recently bought a Chinese financial company given the government's apparent seriousness in opening up the financial sector.

Rogers' strategy of buying long-term, transformational change has served him well ever sine he founded the Quantum Fund with Geroge Soros in 1970 and delivered unheard returns of 4,200% over 10 years.

Now retired in Singapore, that hasn't stopped him from hunting the next big investment opportunities.

He thinks he's found them in China, in the near-term prospects of Korean unification and in Myanmar. *Continued on Page 2.*

Growth At A Scottish Price

First State's Alistair Thompson has helped his firm deliver one of Asia's best track records, all via a unique twist on the traditional GARP strategy.

Alistair Thompson admits finding quality Asian companies at reasonable prices is becoming more challenging: "…our investment style has been very popular in recent years. A lot of consumer companies have performed well and have become richly valued."

It isn't a surprise that First State Investments' Asian strategies are gaining popularity given the consistent out-performance of key funds, such as the Asia Pacific Leaders Fund.

Thompson co-managed that fund with Angus Tulloch for many years before recently stepping aside to focus on the firm's Asian Growth Fund and other mandates.

But the broader strategy remains the same: buying good quality management with strong franchises and healthy balance sheets. Or as Thompson affectionately calls it, with a nod to his firm's Scottish roots: GASP or "Growth At A Scottish Price".

Alistair Thompson

Despite more expensive market valuations, Thompson is still finding stocks that meet his strict criteria. Singaporean banks, OCBC and DBS, as well as Chinese brewer, Tsingtao, being among them.

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Strategy: Jim Rogers

Rogers isn't fazed by the economic slowdown in Asia. He continues to take the long view and thinks the current difficulties are presenting some unique opportunities.

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You've been warning for some time that central bank actions since 2008 have created even deeper problems for the world and a more serious day of reckoning will come. Does that remain your base case?

Jim Rogers: Yes, absolutely. We have all of the major central banks printing staggering amounts of money. We've got this artificial ocean of liquidity out there and it has to end someday. When it does, it's going to be very difficult.

The US is cutting back stimulus while Japan and the EU may be providing additional QE at some point this year. How do you see that playing out? Are emerging markets where the main risks lay?

JR: The main risk lies with the US. The US market is near all-time highs. Emerging markets have gone down a lot already. The risk though is everywhere, including emerging markets.

What kind of triggers are you looking for to indicate that a deeper correction may be near?

JR: A deeper correction may have already begun for all I know, though I doubt it. Usually what happens when markets peak is that you have marginal players going down first.

We're already starting to see some marginal countries and marginal companies decline. If you look at the advance-decline statistics in the US stock market for instance - the indices are making highs but the number of stocks which are making new highs has collapsed.

When a more serious correction starts, what will probably happen is that the US will continue to cut back QE, but at some point it will cause enough pain that the politicians and bureaucrats will give in and stop any further tapering. At that point, markets will breathe a big sigh of relief, resume their climb and

Searching For Big Game

Jim Rogers has led a life that many investors would love to emulate. Growing up as a "poor boy from Alabama" Rogers worked hard as a student, graduating with degrees from Yale and Oxford Universities.

He then worked even harder starting a career on Wall Street. In 1970, he joined investment bank, Arnhold and S. Bleichroder, where he met one, George Soros.

Rogers and Soros went out on their own in 1973, founding the Quantum Fund. During the next ten years, the fund gained 4200% compared with the S&P 500's 47% advance.

That allowed Rogers to retire at the age of 37. Well, not quite retire. He travelled around the world twice, once by motorbike and the other by car, and wrote books about the trips.

"Retirement" also allowed Rogers to invest his own money. And it's here where he's made some now famous calls.

Rogers was talking up China's long-term prospects in the 1980s. It's hard to realise now but very few saw China's potential during this period.

In 1998, Rogers founded a commodities index on the view that commodities had bottomed and were set for a multi-decade bull market. To say this call was spot on would be an understatement.

Rogers has made money from a host of other eclectic investments, including from stocks in the African nation of Botswana, where he recognised this country's potential early on.

Rogers is a deeply contrarian investor with an almost innate curiosity and ability to sought facts from noise.

It seems he's passing on these values to the next generation. Rogers moved his family from New York to Singapore in 2007 because of his belief in the long-tem rise of Asia. But also so his first daughter could learn Mandarin to prepare for the future.

It's in Singapore where *Asia's Money Masters* caught up with Rogers.

then it may even turn into a bubble. At that point, it'll be the last hurrah.

Let's move on briefly to one of the issues making headlines: Ukraine. Markets have largely shrugged off that issue. Is there a chance that they're wrong and this could turn into a deeper crisis?

JR: Well, of course. You go back and look at the history of war - people make mistakes. Country "A" makes a mistake and then country "B" makes a mistake, and all of a sudden, you have people at war. In 1914 for instance, within 6-8 months of the war beginning, people all over the world, including Europe, were saying: "How did we get into this?" That was because it was so absurd what was going on. And yet they didn't manage to end the war until four years later.

That's often how things start. It could happen in Ukraine, but I doubt it. The US and EU don't seem interested in engaging in a war over Ukraine. But you never know. Throughout history people have bungled themselves into wars even though nobody really wanted them.

Even under a worst case scenario such as war, Russian equities look cheap at around five times earnings. Are you a buyer of Russian equities at these levels?

JR: Yes, I bought some in March. And I'll probably buy more before long.

Turning to Asia and the economy everyone's focused on: China. You're on record saying that the economic slowdown in China won't get too serious. Do you maintain that view?

JR: I'm not sure where I said that. Where did I say that?

You've said that there's unlikely to be an economic crash like famed short-seller, Jim Chanos, and others are forecasting.

JR: That's not right. What I've said is that China is the next great country in the world. There'll certainly be setbacks along the way.

In the 19th century as America was rising to power, it had 15 depressions, a horrible Civil War, massacres in the streets and little in the way of human rights. And yet, America turned out to be pretty successful. China will have setbacks along the way. I have no idea what, when, why or how. But China is the

> "If you're in agriculture in China, you won't know whether real estate speculators in Shanghai are going broke because you'll be too busy making money yourself."

largest creditor nation in the world and if and when they have setbacks, I would rather be investing money with creditor nations such as China than debtor nations.

I have frequently said that we'll have people in the real estate business going bankrupt in China because the government is trying to cool off that particular sector. But on the other hand, other parts of the Chinese economy will continue to do extremely well.

If you're in agriculture in China, you won't know whether real estate speculators in Shanghai are going broke because you'll be too busy making money yourself.

Would you suggest that property and local government are the areas which are most vulnerable in China right now?

JR: Well, Beijing has said they want property prices to come down.

They've been saying that for a long time without much long-lasting success…

JR: They've said it on several times and every time in the past when prices were softening, property executives went begging to Beijing and Beijing loosened policy again.

This time, as property prices weaken, the government is again loosening policy. But there will come a time where it doesn't matter how much authorities ease policy: if you have excess supply, you have excess supply. And you won't be able to do anything about it. We're certainly getting closer to that point now.

Conversely, the areas which should still thrive even in an economic downturn: your focus has been on agriculture, water and tourism – do they remain the best structural plays on Chinese growth?

"The government has also said that it'll open up the financial sector. I think it's serious about this and I bought a few shares in a financial company recently as a consequence. "

JR: Those are some of them. Beijing has said that it will let market forces play a greater role in the future. That's fabulous as far as I'm concerned. It's ironic that in 'Red" China, you'll have the market playing a larger role. On the other hand, in the West, people seem to be saying that the government is smarter than the market.

But in China, healthcare is going to get a gigantic push. Railroads, cleaning up pollution and farming too. The government has also said that it'll open up the financial sector. I think it's serious about this and I bought a few shares in a financial company recently as a consequence.

Let's turn from the world's second largest economy to the third: Japan. You've been a critic of Abenomics. Can you outline exactly why?

JR: Japan has decided that it's going to debase the currency and drive up inflation. That's never been a good solution to any problems throughout history. Politicians sometimes can go: "We can control inflation" or "we can control currencies". Sometimes that can work in the short-run but it's never worked in the long run.

Shinzo Abe says he has three arrows to get the Japanese economy back on track. The third arrow is probably going end up in Japan's back.

I own Japanese shares because of Mr Abe's money printing policies. But I think everyone is going to look back at this period in 10-15 years and say: "that's what finally ruined Japan".

As you mention, Japan is trying to depreciate the yen. Do you see the yen heading a lot lower over the next 12 to 24 months?

JR: I'm long the Yen at the moment mainly because there are such huge short positions in the currency- one of the highest short positions that I've ever seen. As I mentioned, I'm not particularly optimistic about Japan or the yen in the long term, but for the moment I remain long the yen. Eventually I'll sell my yen because the current easy money policies in Japan cannot continue indefinitely.

Note that I'm also long the US Dollar even though I'm not particularly optimistic about the long-term picture there either. But I expect more turmoil – certainly currency turmoil. And in periods of currency turmoil throughout history, the US dollar and yen have been perceived as safe havens. They're not safe havens, but I suspect that they will again be among the currencies which people will go to for safety during the next serious downturn.

It would be remiss of me not to touch on some of your favourite themes in Asia, one being Myanmar. Is the Myanmar story still attractive?

JR: Yes it is. There will be ups and downs in Myanmar. Right now, you have military problems with minorities in some parts of the country. There are bound to be other problems cropping up. It'd be awfully strange if a country which suddenly opened up after 50 years of economic decline didn't have these kinds of problems. But I suspect they'll prove to be temporary problems.

There are still doubts about whether the necessary constitutional changes will be made for the opposition leader Aung San Suu Kyi to stand for the presidency next year. Is that essential for further progress to be made in Myanmar?

JR: Certainly not in my view. There'll be setbacks along the way and that may be one of them.

Always when countries open up, things like this go wrong.

It's interesting that you mention this issue. Myanmar's constitution was actually written by Suu Kyi's father. He included in the constitution that if you marry a foreigner, you can't lead the country. Now, everybody is trying to blame this issue on the ruling military junta!

These kinds of issues are bound to come along and present more potential opportunities for investors.

How do you get exposure in Myanmar? There are a handful of stocks in Hong Kong and Singapore. Are there any alternative investments which can give you direct access to Myanmar?

JR: I don't know of any except to go to Myanmar and invest directly yourself. That's not my game though.

I know they're working to open a stock exchange but until that happens, there are limited opportunities for most of us.

Turning to your other top theme: North Korea. There hasn't been a lot of news out of there lately. As an investor, are you happy to sit and wait?

JR: Yes, I don't have any choice!

How do you foresee change eventually occurring in North Korea? Will it be via internal revolution, unification or something else?

JR: I expect unification within a few years. It will probably be the most exciting country in the world, once unification happens.

Who knows if I'm right about unification happening soon. But I'd remind you that Helmut Kohl - one of the most admired and respected German politicians of the past century – was asked in an interview in 1989: when will East and West Germany unite? He said, adamantly: "Not in my lifetime." We all know what then happened in 1989 - the Berlin Wall fell and East and West Germany were united within a year of that interview. So, change can happen quickly.

There are already exciting changes taking place in North Korea which will shock a lot of people. You can take bicycles tours in North Korea now. You can take movie and art tours. There are all sorts of changes taking place.

South Korea's president seems to be at least open to more engagement...

> "With North Korea's cheap labor and enormous resources, combined with South Korea's capital and technology, it would certainly become a potent combination."

JR: Yes, there's no question. But if you listen to American or Japanese propaganda, you'd think the North Koreans are wild savages with no concept of the rest of the world. That's because the Japanese are against unification because they won't be able to compete with a united Korea.

Americans are against unification because they've been against it for 60 years. They don't why they're against it. But partly it's because the US wants to keep troops in South Korea and obviously when North and South Korea unite, part of the deal will be that the American troops will have to leave. China simply won't allow a united Korea with American troops sitting on its border.

Therefore, Japan and America are against the unification but the rest of the world will be for unification.

South Korea would stand out as the prime beneficiary of unification…

JR: With North Korea's cheap labor and enormous resources, combined with South Korea's capital and technology, it would certainly become a potent combination.

One final question on another pet topic of yours: commodities, and particularly gold. You've suggested that there's more downside for gold in the short-term. Is the thesis there that the correction since 2011 hasn't fully played out?

JR: That's partly it. It was very abnormal what happened in gold – it had 12 years without a single down year. Gold hasn't even had at a single 50% correction in at least 14 years. That's very strange! Most assets correct 50% at some point, even in big bull markets. So the price action in gold is still abnormal, in my view.

Also, the fundamentals remain challenging. Indian politicians are blaming their problems on gold. At one point they were trying to force Indians to sell their gold. They may try that again. India has been the largest consumer of gold in the world for years and if the politicians get locals to sell their gold, who knows how low gold could go.

Gold bugs always focus on Chinese demand and they seem to ignore Indian demand…

JR: I know they do. People used to tell me that gold was "holier than thou" and that it would never go down in price. And I'd point out that India is the largest consumer of gold [ed: until recently when China took over that mantle] and it's doing its best to get the gold price down. Well, these people would look at me like I'd flown in from Mars!

We should expect a 50% correction towards US$1000 an ounce then?

JR: I don't know if there's going to be a 50% correction. I'm just pointing out that the fact that there hasn't been such a correction during this gold bull market is abnormal.

I am not buying gold at the moment. In my view, there are still too many gold "mystics"- people who haven't given up despite the declining price. If we have a big wash-out where these mystics give up, then gold will be a great opportunity. Until that happens, I don't see that gold has quite bottomed.

But I hasten to say that if America and Iran go to war, or something else similar, I'll be buying gold even if the price is going up. It partly depends on how the world evolves.

Either way, I do expect another chance to buy more gold over the next two to three years and I hope I'm smart enough to act.

Investor insight: First State Investments

First State's Alistair Thompson says his firm's strategy of buying quality companies, with top-class managers and at reasonable prices is getting popular, but he's still finding Asian stocks which meet his strict criteria.

Backing The Best Leaders

Alistair Thompson is a veteran of Asian equity markets. He's witnessed first-hand Asia's darkest time in 1997 and its extraordinary rise since.

Thompson started at CIM Fund Managers in the UK where he managed money market funds from 1990 and Asia funds from 1992.

In 1993, he switched to Edinburgh Fund Mangers, where he worked for nine years, including as Head of Asia Pacific ex-Japan.

From there, he joined First State Investments. He moved to Singapore in 2003 to integrate various global teams.

Until recently, Thompson co-managed First State's Asia Pacific Leaders Fund with Angus Tulloch. This fund has significantly outperformed its benchmark over multi-year periods.

Thompson is now Deputy Head of First State's Asia Pacific ex-Japan business and manages various funds, including the Asian Growth Fund.

Thompson says his investment style hasn't changed much over the years, being based on backing quality managers at good franchises.

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Your funds management career began in 1989 and you started covering Asia in 1992. It must have been a wild ride in those early days with the large inflows into Asia from 1992-97 and then the subsequent financial crisis.

Alistair Thompson: It was a fascinating experience where you can see markets rise dramatically. I believe in the fourth quarter of 1993, Thailand and the Philippines' stock markets nearly doubled.

Then in 1997, there were brutal declines. And you got the Hong Kong government stepping in to set up the Exchange Fund, for instance.

It was interesting to see the change in management psychology as well. Thai companies in those days would rarely come up to Edinburgh. But all of a sudden in 1998, they were desperate to come and try to get fund managers help to recapitalise their businesses. It went from irrational exuberance to extreme humility.

You moved to from Edinburgh to Singapore in 2003. How did that come about and has it been advantageous to you to be based in the region?

AT: I joined First State in 2003. Colonial had acquired Stewart Ivory in 2000. Stewart Ivory was based in Edinburgh while Colonial had investment teams in Hong Kong and Singapore. I moved down to Singapore in 2003 to integrate those teams properly with Edinburgh, get them on the same incentivisation structure, the same investment process and philosophy and everything else.

One of the main advantages of being based in Asia is corporate access. There are many companies which pass through Singapore. The disadvantage though would be that there is quite a lot of noise so the key is to filter the noise.

Fast forwarding to 2008 and beyond. How do you see Asia's recovery from the financial crisis and the challenges for the region today?

AT: Most of the Asian corporates, ever since the Asian crisis, have been extremely risk-averse so corporate balance sheets are in a good health. I believe the recent financial crisis was one that Asian companies were pretty well prepared for.

As for the main challenges at the moment, China is in a much more difficult position than it was in 2008.

Economic growth there is becoming a lot harder to come by. And then, of course, you've got politics:

North Korea, Malaysia, China, Thailand – it's a risk which is always there in Asia.

From a macro viewpoint, your firm seems to be extremely cautious about economies and markets, particularly in the West at this stage…

AT: I think you have got to understand that the office in Edinburgh is flanked by the Royal Bank of Scotland on one side and the Bank of Scotland on the other.

Well, that explains it…

AT: It's sitting right in the eye of the storm. More seriously, there's still a huge amount of reliance on central banks and a lot of the problems haven't been solved in the developed world. People have been living way beyond their means. The medicine that the IMF prescribed to Asia in 1997-1998 was to stop spending, start saving, sell assets and repay debts. That hasn't really happened in the West post-2008.

Last year, the Federal Reserve Bank's balance sheet grew by one trillion dollars. There's still a huge amount of risk out there.

Conversely, rarely do we have a meeting with an Asian corporate or indeed a central banker where the Asian crisis isn't mentioned. It's still very much at the forefront of their minds.

Your style seems more bottom-up than top-down. Is it too simplistic to say that your style is to buy growth at a reasonable price, or a GARP approach?

AT: Given our Scottish heritage we use the acronym, GASP: "Growth At A Scottish Price".

The first decision we make is: "Is this a good company and should we do some more work on it?" Rather than saying: "China is going to grow at 'X' percent, so let's put 20% of the portfolio in China." It's just the order of the decision.

At the moment, it's very difficult to find value. While the macro environment is terribly important, it tends to come secondary for us. Look at China - it's been the fastest growing economy in the world and one of the worst performing stock markets.

On the other hand, the Indian privately managed banks, for example, have done phenomenally well, even though India has been a challenged market - politically and economically - over the years.

The Asian Growth Fund which you manage runs large country and sector overweights and underweights. Consumer staples are a significant overweight, while with tech, you're significantly underweight. Is that strategic or a consequence of the bottom-up stock picking?

AT: It is a consequence really, although we find that with the technology sector, earnings tend to be a lot more cyclical than other sectors. Essentially because technology becomes commoditised over time and life cycles get shorter and shorter. That said, there are some extremely good tech companies in Asia, like TSMC and Samsung Electronics, which have done very well over the years.

But our process in a nutshell is buying good quality management with strong franchises and healthy balance sheets. We favour consumer franchises because they tend to have significant pricing power and generate a lot of cash.

What do you look for from a company's management?

AT: Our company is called First State Stewart and the word 'stewart' relates to our view. Eight hundred years ago, it was the Scottish word for 'steward' and we very much view our job as stewards of our clients' capital. Equally, we are looking for management which have a similar approach - that they are stewards of our money.

A lot of things go into it: management, integrity, their attitude to risk, the way that they're incentivised which often influences behaviour. All of these things are very important when it comes to management because we want them to take long-term decisions, not be forced by short-term market moves which, unfortunately, are symptomatic of our industry.

Ultimately it comes down to trust: do you want to back these people? And that involves a lot of meetings with them: senior management, middle management, their team factories etc. It's terribly important. You cannot compromise when it comes to the quality of management.

Now, there is no such thing as a perfect company. But you can mitigate a lot of risk by backing good management. We look at their track record, their performance and where they have been at different companies and the makeup of boards of directors. All of these things are absolutely critical because if you look at the First State Stewart's funds' performance since 1988 - when we launched our first Asia Pacific Fund - we tend to preserve capital when risk is high.

Every fund manager will tell you that they're investing in quality companies. The real test is how those companies perform in falling markets and we tend to preserve capital much better in falling markets.

What would be more important: the business franchise or management?

AT: It's difficult. You can have poor management and do some damage to a strong franchise. Brambles in Australia has been challenged in the past. It's not now – you have got some very strong management. But in the past, it has been a bit challenged. Here you have got a very strong business which in some markets has strong oligopolistic traits. But if the management gets it wrong and they incentivise management on revenue and not profits or returns, then it can quickly come unstuck.

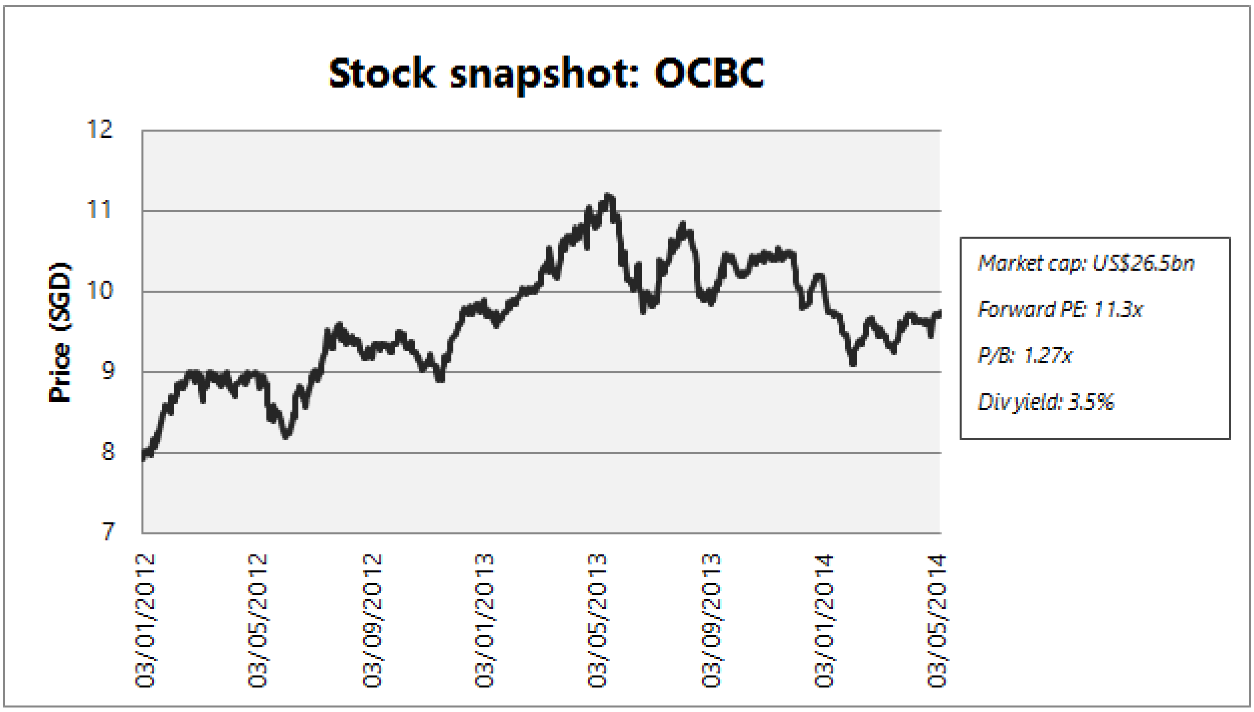
In terms of valuation metrics - which are the ones you look at?

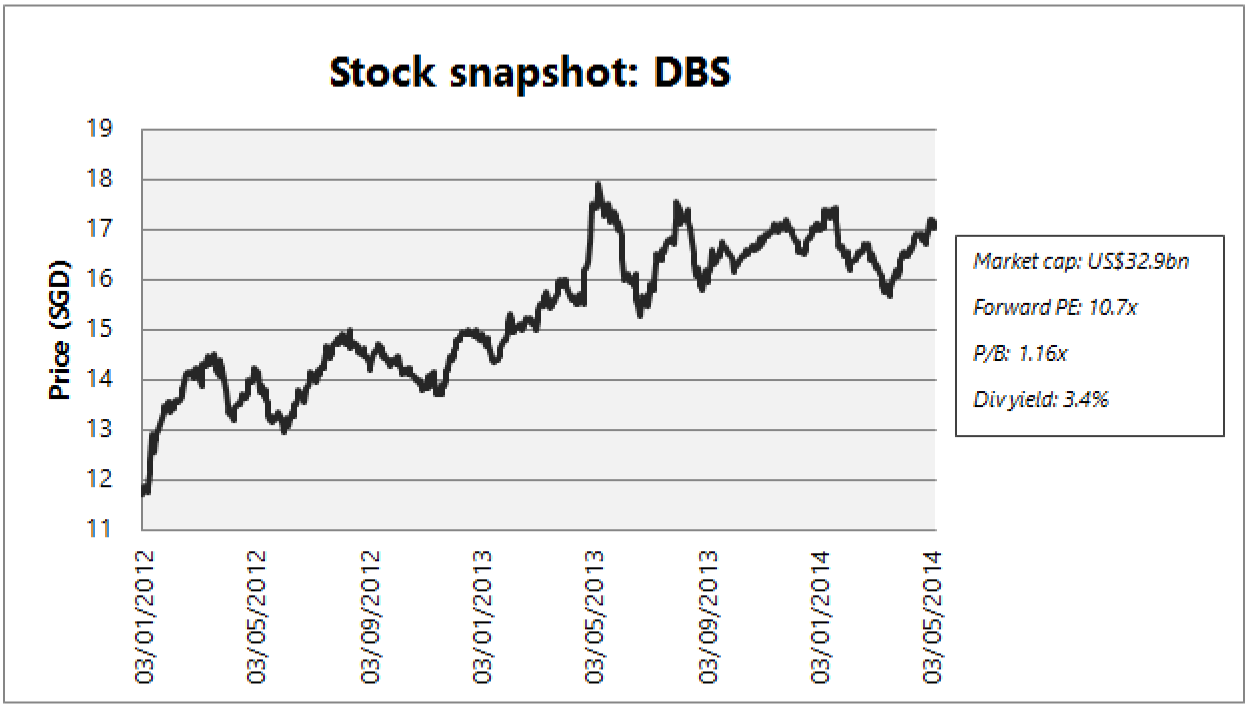
AT: We look at a variety. We look at price-to-cashflow. We look at price-to-book where we can – it's harder to manipulate the book value. We look at market cap per hectolitre for brewing companies. We look at market cap to deposit for banks, which is a good test of the valuation of the franchise there. Replacement costs – that was a useful tool during the Asian crisis. So we look at a whole range of valuation methods.

In the top holdings of your Asian Growth Fund, Singapore banks feature strongly: OCBC and DBS. What's the investment case here?

AT: Number one: the Singapore banks are extremely well regulated. Singapore banks are one of the best regulated in the region, if not globally. Secondly, they're very well capitalised. They have decent dividend yields as well - roughly 4% in Singapore dollars. And we believe the Singapore dollar will continue to appreciate in the long-term.

These banks are also very well managed. DBS has





been a lot more challenged than OCBC over the past 10 or 20 years. Piyush Gupta, the CEO of DBS, is doing a fabulous job and that has been reflected in the share price.

But both companies still look reasonably cheap: DBS trades at a small premium to book value. OCBC is a bit higher because the returns of equity are higher.

Net interest margins have been under pressure at both and one of the main reasons is that interest rates are extremely low and in our view unsustainably low globally. These margins will rise when interest rates rise and so should returns on equity.

They are two very high quality companies that you can sleep well at night. Until interest rates start to go up though, we don't see too much upside for these stocks in the short-term.

What are your thoughts on OCBC's recent acquisition of Wing Hang Bank in Hong Kong.

AT: There are relatively limited acquisition opportunities for banks in Asia. Wing Hang is an opportunity for OCBC to expand in China. The valuation that OCBC is paying is a full one and it'd be the first to admit that. But Wing Hang is a well-managed bank with a good franchise and it gives some growth opportunities beyond OCBC's existing markets.

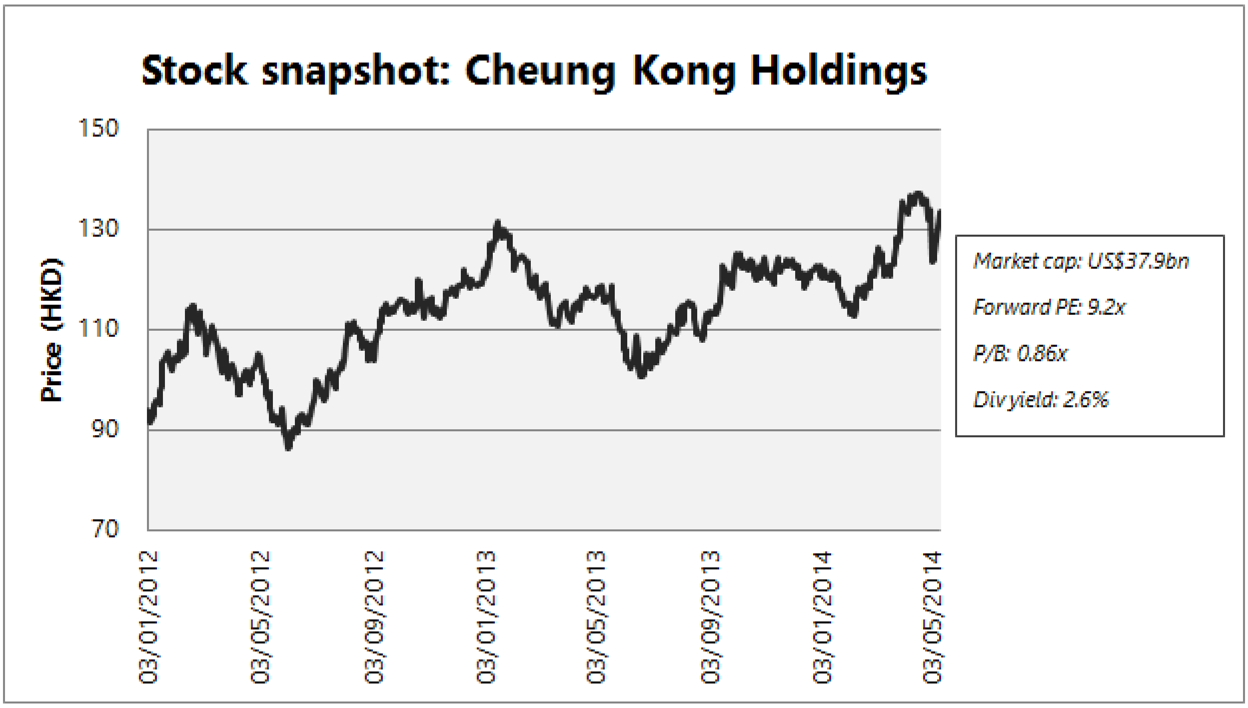
Your fund has heavy exposure to Li Ka-shing's companies, including Hutchison Whampoa and Cheung Kong. What's the rationale behind those investments?

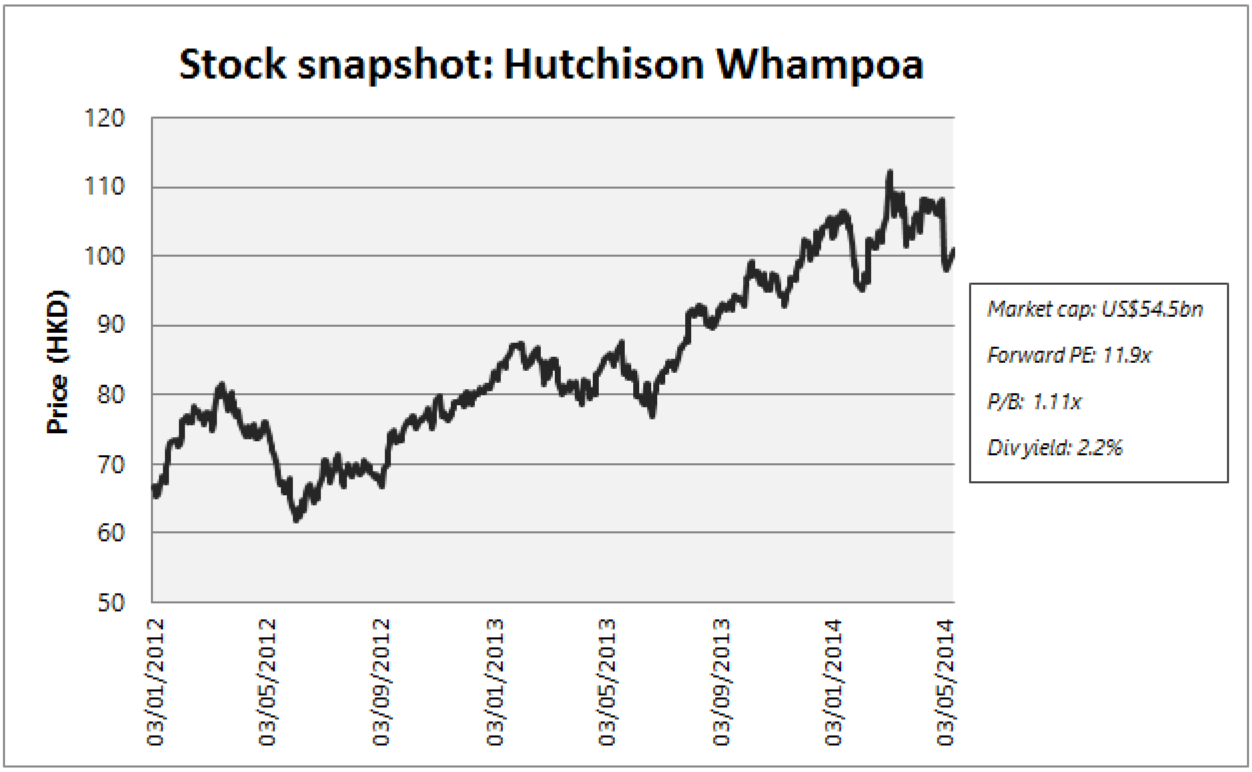
AT: Li Ka-shing is the wealthiest man in Asia and it probably pays to keep a close eye on what he's doing. He continues to buy shares in these companies as do other senior managers. These companies have quality management. They have some great assets in property, ports, power, telcos, water and supermarkets. The balance sheets are very strong. There have also been special dividends from Cheung Kong. Thus, Li Ka-Shing is prepared to treat minority shareholders well.

Li Ka-Shing is also a very good trader of assets. He's been a heavy investor in the UK at the bottom and arguably has called China extremely well [selling assets there over the past 18 months].

Li Ka-shing is 85 years of age. Is there a succession issue at these companies?

AT Yes there is. Victor Li, his eldest son, is the heir apparent. Victor has a reputation for being a safe pair of hands. He probably delegates a bit more than





his father. Li Ka-Shing remains very involved in the businesses though.

These companies aren't run for the next one to three years. They're run on a much longer investment horizon than your average equity investor has and therefore the decision making tends to be a bit more measured.

We're not too worried about the succession issue. It's an issue across a lot of companies in Asia. But on the whole, Li Ka-shing is managing this issue pretty well.

Is there a lot of upside for Hutch and Cheung Kong at current levels?

AT: Cheung Kong is trading at a 15% discount to book value and that is attractive. Hutch isn't as cheap. But then you have got the telco assets which are looking a lot better now, having had problems for the past 10 to 15 years.

You're referring to the European telecommunication assets?

AT: That's right. Perhaps earnings forecasts are being under-estimated at Hutch.

We're pretty happy with the holdings. We use the analogy that a portfolio is like a garden: it's the herbaceous border portfolio theory. I don't know if you have heard it, but it's essentially that in your portfolio, you don't want all of the flowering and blossoming at the same time. You want some colour during winter and you tend to have your hardy perennials and then you have your smaller companies which hopefully will take root, grow and flourish. Or, indeed, if they don't, then you weed them out.

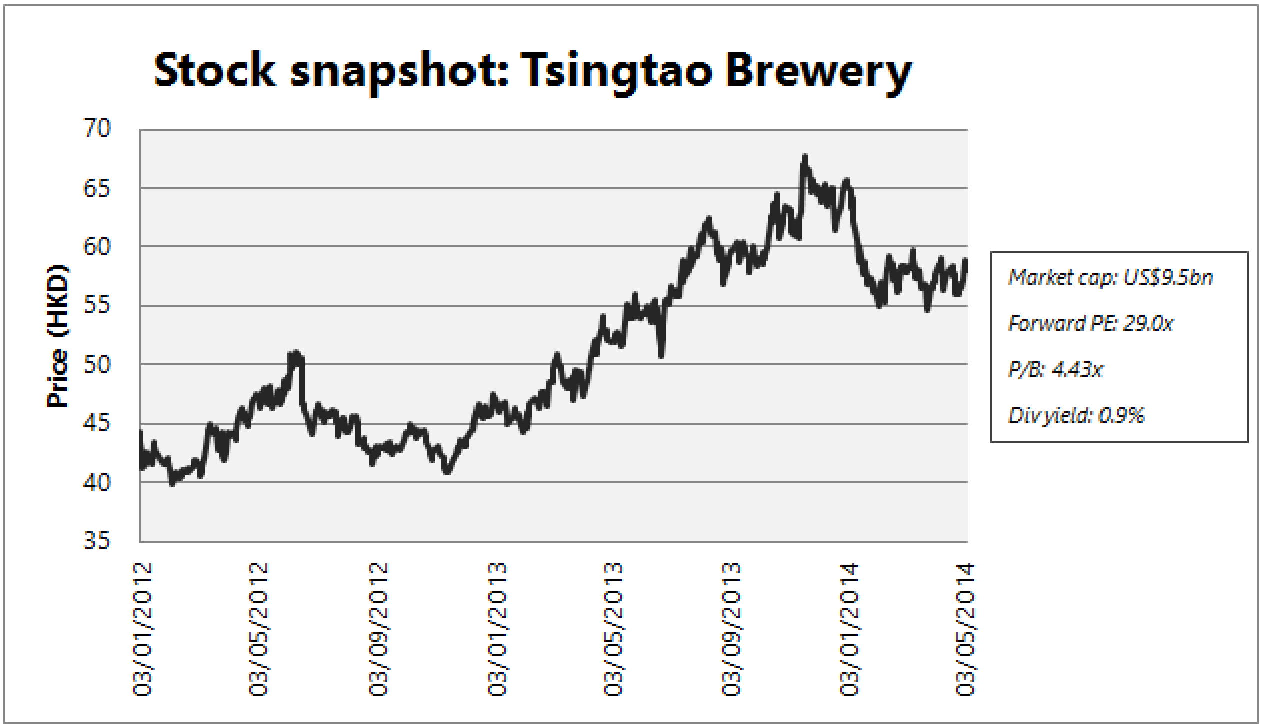
Cheung Kong and Hutchison - just like Hong Kong China Gas and CSL in Australia - these are hardy perennials. These are companies which have been in our portfolio for many years. We envisage they'll be in the portfolio for many more years because they're very good stewards of capital.

With these "hardy perennials" then, if they reach fair value or a bit above, you're unlikely to be sellers?

AT: That's right. This is the challenge at the moment because our investment style has been very popular in recent years. A lot of consumer companies have performed well and have become richly valued.

I was going to mention earlier that the consumer companies have had a great run of late, particularly in Thailand, India and even Indonesia. The consumer sector does look expensive especially versus some other sectors such as financials…

AT: Yes, though we're still finding some opportunities. Recently, we've bought Tsingtao Brewery in China, which has a PER in the mid-20s [ed: having moved up to 29x since purchase] having come down from the mid-30s. Maybe that will be dull for the next couple of years but we're quite fortunate that our investment horizon is three to five years.



Investor insight: Asia Frontier Capital

CEO Thomas Hugger has formed Asia's only frontier fund because he believes these markets offer the prospect of extraordinary, long-term returns.

Asia Frontier Capital was formed last year after a management buy-out from the highly successful Leopard Capital. Can you tell us a bit more about how Asia Frontier Capital came to be?

TH: Leopard Capital was originally set up as a leading manager of private equity funds in frontier markets in Asia. It branched out into equities and formed various funds, such as a Cambodia fund in 2008.

Leopard's Asia Frontier Fund was launched in 2012. It started out small but we hoped that through our contacts there would be demand for the offering. Unfortunately, it turned out that demand was soft. There were probably a few reasons for this. One was a lack of focus on a single investment approach when we presented to clients as we were managing both private and public equity funds that tend to be attractive to different types of investors. At the time of launch, frontier markets were even less understood than they are today.

Another thing is that I started the fund and managed it from day one, and yet I wasn't the public face of the Asia Frontier Fund. I come from a trading and fund management background so I know this wasn't ideal as investors in boutique funds want to know who is managing their money and what is impacting their portfolio. I thought it would be better for clients to have a dedicated fund where I could direct my focus and open up communication to guide investors through our markets and public equities portfolio.

So the decision was made to split the business and Asia Frontier Capital was born.

Why the focus on Asian frontier markets? What's the attraction there?

TH: The attraction is that these markets have large populations, 572 million in aggregate, high economic growth, are overlooked by foreign investors and most are very cheap compared with emerging markets. These markets also have low labour costs with very large numbers of hard working young people that are increasingly educated, tech savvy and connected with the global economy.

Hunting Undiscovered Markets

The CEO of Asia Frontier Capital (AFC), Thomas Hugger, has been investing in frontier markets for more than 20 years. For him, nothing beats finding great companies which are completely off the radars of other institutional investors. Getting in on the ground floor, so to speak.

Hugger has held senior positions at Bank Julius Baer in Zurich and Hong Kong. He was also a Managing Director and Head Of Portfolio Management at LGT Bank in Hong Kong.

Prior to AFC, he was a Managing Partner, CFO and COO at the highly-regarded Leopard Capital.

That was before he decided to form his own venture in 2012. He's not only CEO of AFC but runs the main fund, the AFC Asia Frontier Fund.

Despite the recent out-performance of frontier markets, Hugger believes there's still a lot of value left in these smaller markets.

Can you outline the main Asian frontier markets, their market sizes and daily turnover?

TH: There are four large markets in our universe: Vietnam, Sri Lanka, Pakistan and Bangladesh. Their respective market sizes are around 60, 20, 70 and 38 billion and daily turnover, with the exception of Sri Lanka, can easily reach US$100 million on a good day.

That's more than I would have expected...

TH: It is quite a bit, yes. And the number of available stocks is quite large too. Vietnam has two stock exchanges and there are around 675 listed stocks. Pakistan has various stock exchanges, but the main stock exchange in Karachi has 570 listed stocks. While smaller, Sri Lanka has 293 stocks. And in Bangladesh, there are 260 listed stocks, a number which is rising.

If you go deeper into the other markets, some of them are quite small. Laos only has three publicly-traded stocks!

You can't be too choosy in Laos then. More broadly, frontier markets have performed quite well over the past year, a surprising feat given QE tapering has taken its toll on the larger markets in Asia. Why do you think frontier markets have outperformed?

TH: There are two main reasons. First, foreign capital contribution to daily trading in frontier markets is very low. In Vietnam, it's close to 5%. In Bangladesh, it's just 2%. So foreign money didn't flow into these markets initially and didn't flow out when tapering started to happen.

Second, and this is related to the first – frontier markets have low correlations to the rest of the world. The MSCI Frontier Asia Index has a correlation of just 0.35 to the MSCI World Index. That compares to the MSCI Emerging Markets and MSCI BRIC indices which each have a correlation of 0.82 to the World Index.

As for individual markets, Vietnam has the highest correlation at 0.59. But others are much lower, with Pakistan at 0.33 while Bangladesh is negatively correlated to the MSCI World Index!

I imagine some of the pushback you get from investors is that high economic growth doesn't necessarily translate into superior stock market performance. How do you counter that argument?

TH: So you want to talk about China?

Well, it's broader than that. Credit Suisse research has found past GDP numbers have little bearing on future stock market returns…

TH: Sure, but much depends on the price that you pay. And frontier markets look very, very cheap versus the developed world right now.
Also, and this is talking our own book, but it helps to have active equities managers who look beyond the index, particularly in more volatile environments such as frontier markets.

Frontier markets do have a number of quirks and I imagine liquidity risk is an issue. You said earlier that there is a reasonable liquidity across the four large Asian frontier markets. But I'd guess entering and exiting stocks is still an issue for you…

TH: Certainly. And we tend to look at value stocks, many deep value ones. These are under-researched and often even less liquid as a result. It takes patience to acquire them.

Currency would also be an issue. Do you hedge currencies at all?

TH: No, we do not hedge and sometimes it is not even possible to hedge. Part of our approach involves macro, top-down analysis. And as part of that, we focus a lot on currency risk. You have to take these things into account in these kinds of markets.

Can you talk about your investment style in more detail?

TH: It's a combination of top-down and bottom-up. We try to identify the most attractive economies and markets from a macro perspective.

Getting this allocation right is critical and there have been some opportunities forgone on this front since the founding of the fund two years ago. Given the substantial economic risks at that time, we were initially underweight Pakistan. With 20-20 hindsight, that has not turned out to be the optimal allocation as Pakistan has turned out to be a very good performer. However, the missed opportunity from a portfolio allocation level has been offset by our focus on bottom-up stock picking which has seen some great returns.

Why has Pakistan been a stellar performer?

TH: It was under-owned and the incrementally better news produced a big turnaround in market fortunes. It doesn't need much for these markets to turn.

On my recent trips to Pakistan, what's stood out is that stock brokers and others in the market hardly see foreign investors coming through. That's normally a positive sign.

Don't get me wrong, Pakistan has some big problems but those problems can be overblown.

In other words those problems can be embedded in valuations and you can make money as a consequence…

TH: Yes. One of our best performing stocks has been one of the first that we bought for the fund. It's a brewer in Pakistan called Murree Brewery. When we first bought it, the broker said: "Are you crazy buying a brewer in a Muslim country?"

What was the thesis behind buying the stock?

TH: The valuation was very cheap to us. Price to book was around 0.4x and the price to earnings ratio was 5x.

Part of the thesis was also that a new government in Pakistan would tone down the rhetoric towards India and Murree could start exporting beer there.

Has that happened?

TH: No it hasn't. Because of that, management is considering making the beer in India itself to sell into that country.

They have also entered into other products in their home market, such as soft drinks and juices.

What kind of upside do you think the stock has from here?

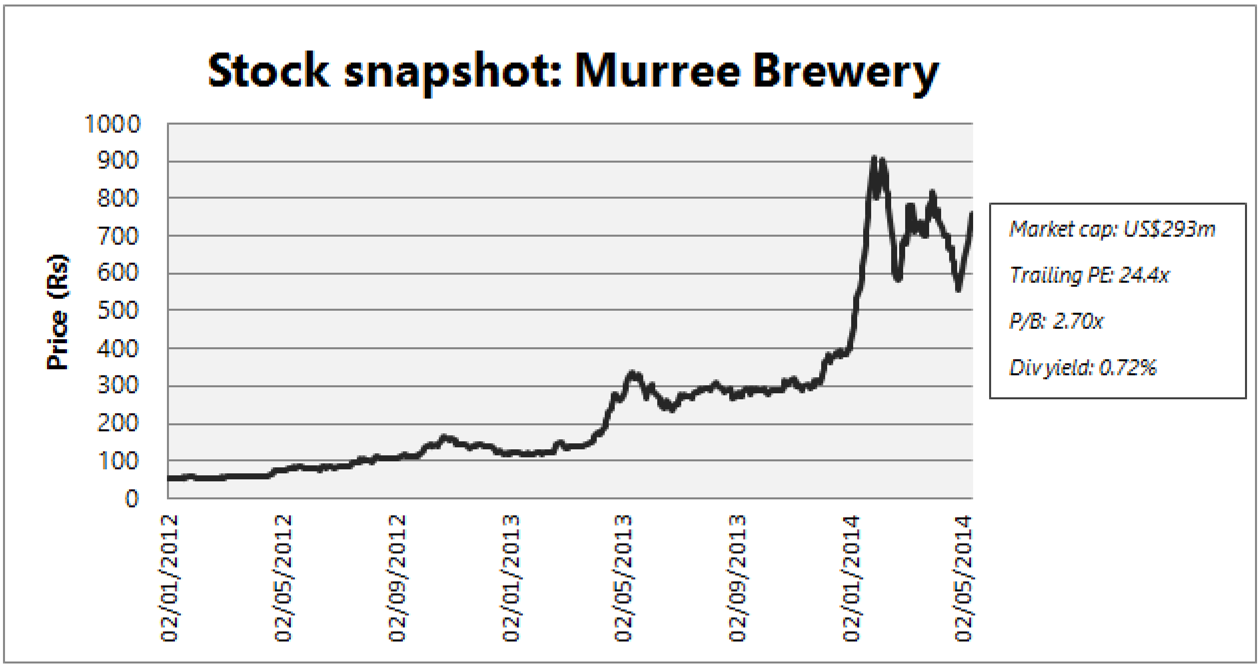
TH: We bought the stock at 80 and it's now trading around 680.

Wow!

TH: So the stock went up a lot already in less than two years.

And it still has upside?

TH: We think it still has upside. It remains the cheapest consumer stock in Pakistan.



Turning to another big market that you cover: Vietnam. It had a credit crisis 2-3 ye ago and seems to be just turning the corner. Is that how you see it?

TH: The country is an excellent turnaround story. It has taken a while for Vietnam to turn the corner but part of that is the bureaucratic machinery of the Communist government there tends to move a bit slower.

Is the Vietnamese government committed to reform?

TH: They were very slow at the beginning, but I think they really are behind it. The banks are now being cleaned up via the establishment of a "bad bank" to purchase some of their bad debts. This has some way to go and will inhibit credit growth in the short-term.

Tell us about one of the Vietnamese stocks in your portfolio, Vinasun, the largest taxi operator in the country…

TH: The story of Vinasun is that it has quickly grown from being the number four taxi company in Vietnam to number two, in terms of market share. It's privately-owned and operates in and around Ho Chi Minh City. It plans to expand into Hanoi, perhaps in the fourth quarter of this year.

What kind of competition does it have?

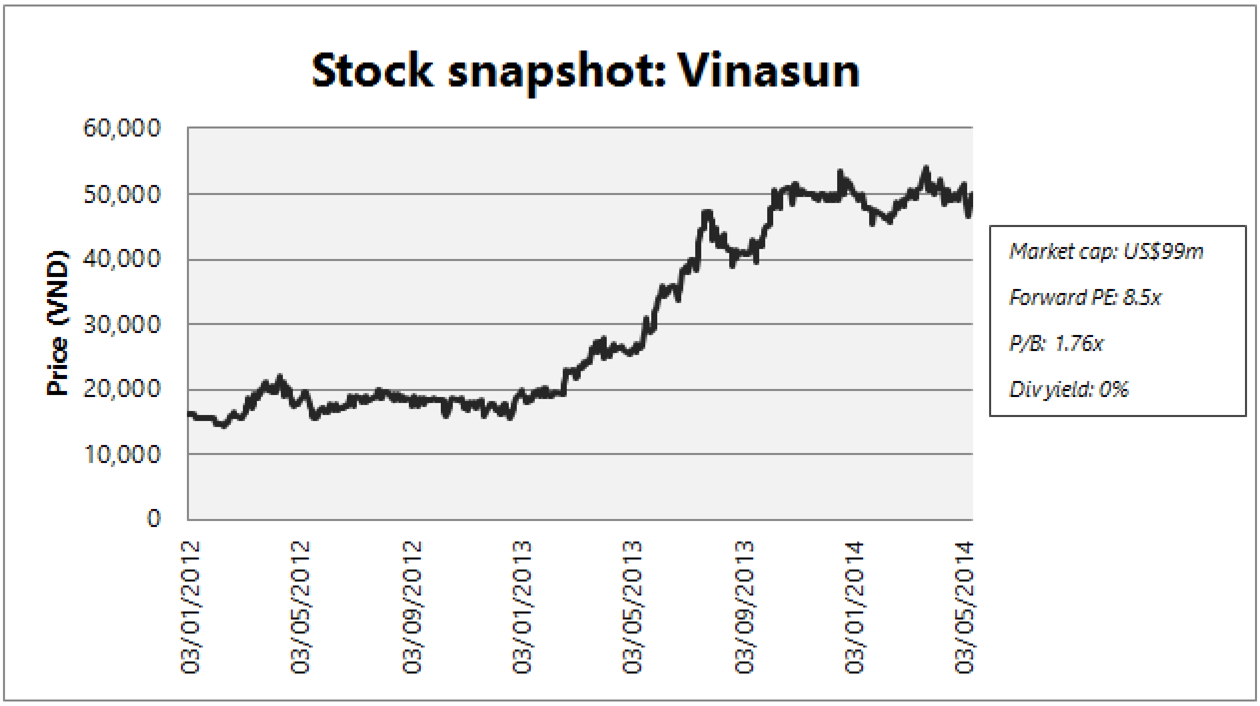
TH: There are two big players - Vinasun and Mai Linh. An interesting thing is that Mai linh Taxi is part of a larger business which has some financial distress due to bad investments in the property sector and other things. Therefore, Mai Linh doesn't have the capital to further grow the taxi business. That should play into Vinasun's hands nicely.

What are the main risks for Vinasun?

TH: If a company grows and goes into new areas there's always risk, but I think the main risk perhaps is government policy-related. The traffic is chaotic in Ho Chi Minh City and there's always a risk that the government implements traffic restrictions like those in Singapore or London. Other policy risk includes any future increases in gasoline prices.

Vinasun appears cheap...

TH: It's under 9x PE. If you compare that to similar



companies in neighbouring countries, it does look cheap. For example, Express Transindo in Indonesia is trading above 20x PE.

It's a good example of the value in frontier markets. The difference in valuations between these two taxi companies can be largely put down to foreigners having easier access to Indonesian markets vis-à-vis Vietnam.

Let's look at one final stock in your portfolio: Sri Lanka's United Motors Lanka, a leading auto distributor in the country. Can you describe this business?

TH: Their main business is importing Mitsubishi cars. Mitsubishi also has a small stake in the company which started as a private entity in the late 1950s.

It started to import other brands, such as trucks from China and India. It has plans to import a new small car from China which will be the cheapest car in Sri Lanka.

Well, it won't exactly import the car as such. It will instead import the parts and assemble them on a new piece of land just acquired outside of Colombo, Sri Lanka's capital.

I like the company because I am from Switzerland (which does not manufacture any cars) and the owners of the two largest auto distributors there are also among the richest men in Switzerland.

It's a service business which isn't capital intensive, resulting in high returns on equity, I imagine?

TH: That's correct.

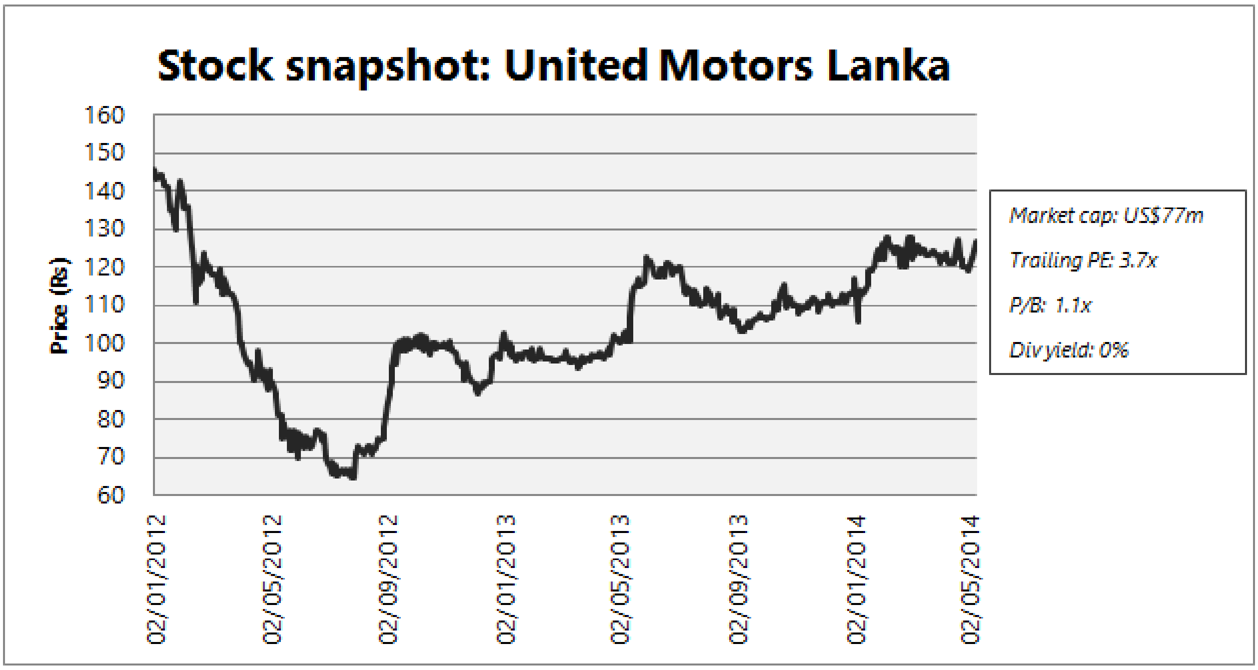
And the main risks for the stock?

TH: The government introduced taxes on car imports and, who knows, that could ramp up. But that's why the stock was so inexpensive in the first place. We bought the company when it was trading at under 2x earnings.

By the way, government risk in Sri Lanka is ever-present and a reason we are underweight the country at the moment.

And do you see a lot more upside for United Motors Lanka?

TH: We see tremendous upside given the likely increases in disposable income in Sri Lanka translating into higher car ownership. This kind of story has played out in the likes of Indonesia and Thailand and there's no reason to think that it can't in Sri Lanka too.



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Each issue has 2-3 extended interviews with these investors, typically covering a broad range of topics including:

- Stocks that they've recently bought and sell
- The reasoning behind the stock purchases and sales
- Their investment strategies
- Their investment processes
- Views on Asia's macro-economic environment
- Analysis of latest Asian news and trends

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