

Pacific Assets Trust

Initiation: First State overhauls inherited portfolio

Wary of consumer stock 'bubble', focus on South East Asia

Overview: Given that the portfolio repositioning is now over 95% complete and the discount has widened out to 10%, allied to the fact that we view First State as one of the better, long established Asian fund managers, we have initiated coverage with a **BUY** recommendation. We view the fund as being suitable for those who share the managers' caution on Asian consumer stock valuations and inflation and appreciate the managers' focus on downside risk. The current estimated discount is 10% to NAV against a 12 month range of 12% to 0%, making it look relatively good value when compared to its historic range.

Portfolio positioned using First State's 'Asia sustainability strategy': Having inherited the portfolio in July, David Gait and team at First State Investment Management have radically restructured the portfolio, keeping only 6 of the holdings and adding 39 'favourites', leaving the transition around 95% complete.

Bubbles emerging: First State remains concerned over the perceived property bubble in China and PAC is now biased towards companies that are not sensitive to interest rate rises. Inflation is a concern across most of Asia, while First State has sounded caution on consumer stocks, many of which are now 'priced for perfection'. Put simply, tapping the Asian consumer is now a well-worn theme that has become popular with marketing departments and continues to suck in money. This is exemplified by the plethora of Asian consumer funds and ETFs now available. As a result of these concerns, it has been selling some consumer stocks on the basis of valuation and finding most of its new ideas outside China and India in smaller, less hyped markets. It is currently finding particular value in the smaller, traditional, conservatively managed South East Asian banks. We show the ten largest holdings and geographic weightings overleaf.

Sustainability strategy: The team sets out to invest in companies that are well positioned to deliver long-term returns in the face of the huge development challenges Asia faces today. These are seen to include land and water scarcity, resource constraints, population pressure and extreme levels of poverty. For some, these challenges represent key risks to their business. For others, they represent opportunities to build good quality business franchises that will stand the test of time. It is the latter group in which First State aims to invest. The focus is on finding attractively valued companies with good quality management teams and strong franchises capable of performing in both good and bad times.

Fees: An annual fee of 0.75% of net assets is to be paid and an additional performance component at the rate of 12.5% of returns in excess of the benchmark plus 1.75% per annum, measured over a rolling three year period. The Board has capped total annual investment management fees at 1.75% of net assets.

Unconnected research

Initiated:	BUY
Price:	118p
Cum inc NAV:	131p
Discount:	10%

As at 15:00 on 30 September 2010

Market Cap:	£138m
Active leverage:	0%
Av disc (1yr):	7.4%
Lead managers:	David Gait Stuart Paul
Management fee:	0.75%
Reuters:	PAC.L
Bloomberg:	PAC LN

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Performance

Given that the new managers only took over running the portfolio in July it is too early to judge their performance in relation to PAC. However, the First State team have built a strong reputation running open end funds and in our view their defensive, stock picking style should fare well in choppy markets. According to Morningstar, over the last three years, the First Asia Pacific Sustainability open end fund is ranked 3rd out of 93 funds. Now that the reconstruction of the portfolio is nearing completion, we anticipate positive relative performance on a three year view.

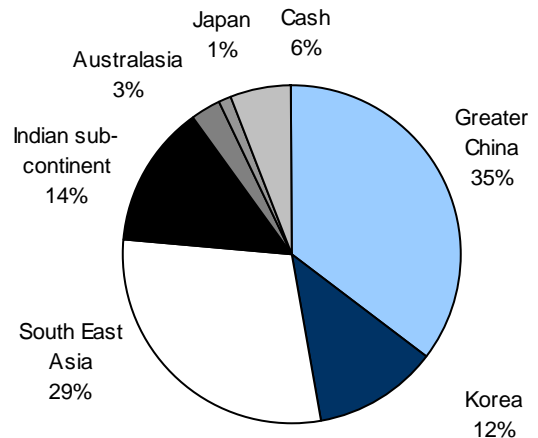
Bottom-up stock-pickers: No heed is paid to the benchmark weighting when picking stocks. That said, the new managers believe their approach will ensure that the Company outperforms the benchmark by at least 1.75% per annum on a rolling three year period as well as ranking in the top third of its peer group on a rolling three year basis. But given the approach, the managers expect to have periods of both relative underperformance and outperformance within a three year time horizon.

Top 10 holdings

	% of portfolio
MTR	5.4
LG Corp	4.9
Taiwan Semiconductor	4.5
E.Sun Financial Holdings	4.1
Manila Water Company	4.0
Singapore Post	3.9
Kasikornbank	3.7
Hong Kong & China Gas	3.6
SMRT Corporation	3.5
Transport International	3.4

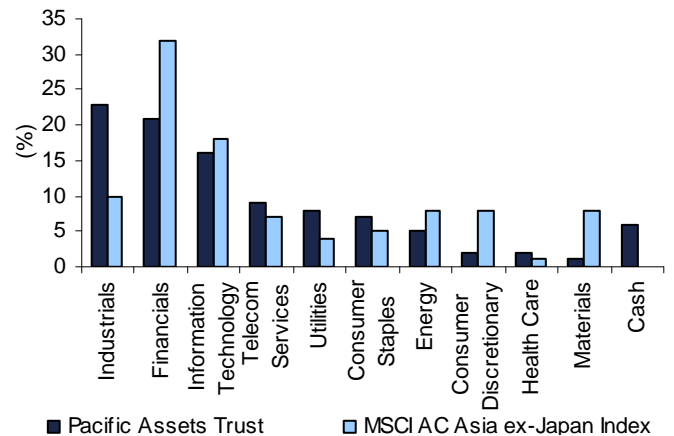
Source: Pacific Assets, 31/07/10

Geographics



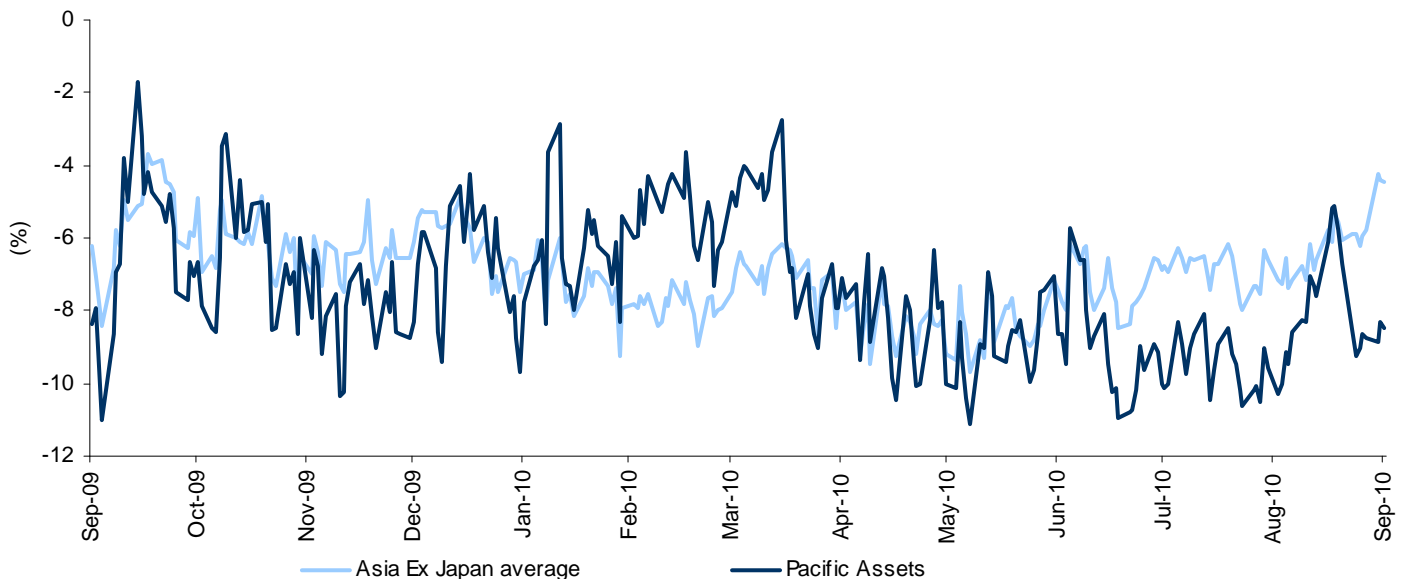
Source: Pacific Assets, 31/07/10

Sector breakdown



Source: Pacific Assets, 31/07/10

Discount comparison: Pacific Assets vs Asian ex-Japan sector average – 1 yr



Source: Thomson Datastream

Disclosures

Pacific Assets Trust

Date	Recommendation
Initiated on 29-Sep-10	BUY

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