

Thursday, 29 September 2011



## Funds Commentary

### Highlights

**Pacific Assets (PAC; Positive) – One year on - new management strategy working well in tough markets. Dividend set to rise as earnings double.**

### Details

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Price (p)	Cum inc NAV dil. (p)	Discount est. (%)	Market Cap (£m)	Yield (%)	Next News
112	123	9	132	1.2	IMS December

*Investment policy: To achieve long-term capital growth through investment in selected companies in the Asia Pacific region and the Indian sub-continent, but excluding Japan, Australia and New Zealand. The benchmark index is the MSCI All Country Asia ex Japan Index (total return; Sterling adjusted).*

*Oriel View: On 27 September Pacific Assets released interim results for the period ending 31 July. The performance table below shows just how divergent NAV returns have become among funds investing in the Asian region, with a range over one year of -27% to an astonishing +2% for Aberdeen Asian Income (AAIF; Positive). The cautious stance adopted by First State in managing Pacific Assets has served it well in its first year as manager: it ranks as the third best NAV performer over one year, if one strips out small cap funds. We initiated coverage with a POSITIVE recommendation in October last year, post the appointment of First State as manager. At the time we viewed the fund as being suitable for “those who share the managers’ caution on certain Asian consumer stock valuations and inflation and appreciate the managers’ focus on downside risk”.*

*The current estimated discount is 9% to cum income NAV against a 12 month range of 12% to 3%, making it look relatively good value when compared to its historic range. The ‘new’ team, led by David Gait and Stuart Paul, have sought to differentiate the fund by adopting a conservative investment style which was expected to underperform in bull markets but outperform in bear ones. So far the strategy, if rather dull, has worked well in what have been tough markets. First State still believes that in general, investor expectations remain too high, with regard to Asian equities but are convinced that over the long term their strategy will deliver positive returns for the patient investor. We share their optimism and are encouraged by news in the recent interim results that dividends are set to increase. We maintain our positive stance, viewing PAC as an ideal fund for core Asian exposure (ex Australia & Japan).*

**Performance ahead of benchmark and most of the peer group:** During the six month period the NAV total return was +2.1% which compares to a total return from the sterling adjusted MSCI All Country Asia ex Japan Index of +0.9%.

**Leverage facility cancelled in May** – in light of the fact that the management team saw and continue to see no reason to use it in the near term.

**Earnings up 170% to 1.95p (0.72p):** The investments selected by First State have led to an a higher level of income when compared to that of the previous Investment Manager. This, together with lower costs, particularly relating to marketing and savings scheme administration, has resulted in an increased level of net revenue for the period under review to £2.3m (six months ended 31 July 2010: £0.9m).

**Significant scope for dividend increase:** The Board expects that, on the basis of revenue estimates for the full year, the Company's dividend will be greater than in the previous year. The Board reminds shareholders that it remains the Company's policy to pursue capital growth for shareholders with income being a secondary consideration. The amount of the dividend for the full year to 31 January 2012 is expected to be announced in March 2012.

**Outlook – patience to be rewarded:** With global economic issues such as credit concerns in the highly indebted euro-zone countries and also the ability of the US administration to address the high levels of government debt continuing to unsettle investors, the board sees it as likely that markets will remain volatile whilst these uncertainties persist. However, it continues to believe that the long term investment case for the Asia Pacific region remains robust due, in part, to its demographics and continued high levels of investment spending and is confident that the patient investor in the Asia Pacific region will be well rewarded over time.

**Pockets of value have emerged but in general Asia not especially cheap relative to Europe and North America:** `BRIC' markets are seen by David Gait and his team as remaining overvalued whilst 'peripheral' areas of the market such as Korea, the Philippines and Taiwan, continue to offer good pockets of value. Indeed the managers point out that in their view many good quality companies in the US and Europe appear to be much more reasonably priced at present than their Asian counterparts and suggest that maybe investors in Asian equities are expecting a little too much.

**China remains a concern as inequalities mount:** The manager reports that a potential epicentre of political risk remains China and suggests that the economy looks out of balance, with an over-reliance on state-sponsored, state-managed capital allocation. It does however point out that state control is not always a bad thing and that private enterprise has caused plenty of problems for Western economies in recent years. That said it argues that the challenges thrown up by the Chinese economic model are huge and the balancing act is becoming ever harder. It quotes an *Asianomics* report that notes that China has '*gone from being the most equal society in all of Asia...to the most unequal society in all of Asia in the space of one generation.*'

**Environmental, social and governance issues (ESG) focus gives team the edge:** 'Engagement' with management teams is one way in which PAC aims to reduce the risk in its portfolio. Its engagement approach is evolving over time, thanks to the arrival of new services such as Rep Risk. Rep Risk is a service provider which aims to gather all the negative news items which potential investee companies would be unlikely to readily divulge themselves. It allows Gait and team to go into each company meeting armed with a list, sometimes long, sometimes short, of key environmental, social and governance (ESG) issues concerning the company. In Gait's view, engagement provides a very useful insight into a wide range of important criteria used to assess overall quality of management. These range from insights into management integrity, board oversight and corporate attitude to risk, to the strategic vision of management in positioning their businesses for shifting consumer trends and regulatory risks. We note that Oriel corporate client **Vietnam Holdings\*** (VNH) is also keenly focused on ESG issues and that management see it as a crucial part of the investment process.

**Management confident on quality of investee companies:** *"We have no idea how long the storm will last. We are convinced, however, that when it does pass, our companies will emerge in a strong position to deliver attractive returns to those prepared to invest for the long-term in the region."*

**NAV Total Return ranked over 1 year (%)**

<b>Fund</b>	<b>6mths</b>	<b>9mths</b>	<b>1yr</b>	<b>2yr</b>	<b>3yr</b>
Impax Asian Environmental Mkts	-30	-33	-27	-	-
JPMorgan Asian	-26	-28	-22	-5	28
Henderson TR Pacific	-24	-27	-20	-5	38
Pacific Horizon	-19	-22	-15	2	37
Fidelity Asian Values	-18	-20	-14	7	53
Henderson Far East Income	-16	-21	-14	-1	32
Aberdeen New Dawn	-13	-19	-12	19	61
Edinburgh Dragon	-14	-19	-11	17	63
Schroder Asia Pacific	-16	-16	-8	14	57
Invesco Asia	-15	-16	-8	10	58
Scottish Oriental Smaller Cos	-12	-17	-8	36	110
<b>Pacific Assets</b>	<b>-10</b>	<b>-15</b>	<b>-7</b>	<b>7</b>	<b>34</b>
Aberdeen Asian Smaller	-6	-12	-6	52	115
Schroder Oriental Income	-11	-15	-3	24	70
Aberdeen Asian Income	-5	-6	2	26	64
<i>FTSE All-Share Index</i>	-12	-13	-6	8	14
<i>MSCI AC Asia Pac ex Jap £</i>	-19	-22	-14	1	37
<i>MSCI WORLD FREE £</i>	-12	-12	-2	7	14
<i>MSCI AC Asia ex Japan</i>	-20	-22	-15	1	42

Source: AIC, data as at 26.09.11

**Ten Largest Holdings (% of net assets)**

<b>Name</b>	<b>Country</b>	<b>Total %</b>
DBS Group	Singapore	5.3
Taiwan Semiconductor Manufacturing	Taiwan	5
Manila Water	Philippines	4.5
Hong Kong & China Gas	Hong Kong	4.3
Singapore Telecommunications	Singapore	4.2
DGB Financial Group	South Korea	3.6
Kasikornbank	Thailand	3.6
Samsung Fire & Marine Insurance	South Korea	3.6
Delta Electronics (Thailand)	Thailand	3.2
Singapore Post	Singapore	3.2
<b>Total</b>		<b>40.5</b>

Source: co factsheet as at 31 Aug 2011

**Portfolio Allocation as at 31 July 2011 (%)**

Singapore	17.6
Taiwan	16.6
Hong Kong	15.6
South Korea	12.7
India	11.3
Thailand	7.6
Philippines	7.5
Liquidity	6.4
China	2.5
Malaysia	1.2
Indonesia	0.5
Sri Lanka	0.5
<b>Total:</b>	<b>100</b>

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NR = not rated

*The Funds Commentary is prepared by Oriel Investment Funds Research and Sales*

