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MANAGER SPOTLIGHT

PROFILE

Searching for alpha in Asia

Written by: Wouter Klijn

Global fund managers, having the entire world as their investment universe, would theoretically have access to many more good investment opportunities than domestic fund managers. But the barriers thrown up by a profusion of languages, legal systems and market regulations may not always be easy to overcome.

The alternative is to find good local fund managers that have thorough knowledge of the intricacies of the domestic markets and bundle these managers into a single fund. This is exactly what Pengana has done in its Global Small Companies Solution. "I've been scouring the world for good small-cap managers, regional small-cap managers, for a number of years," Pengana Capital chief investment officer Nick Griffith says.

Griffith documents all new appointments or departures at small-cap funds management teams around the world. "It is quite a dynamic universe and you often see people leaving larger shops to set up boutiques, for example," he says.

But he also relies heavily on his contacts in the investment community to provide him with tips on new fund managers. "They know my interest in small-cap managers and they keep me informed on what is going on there," he says.

Pengana's fund includes three regional managers: Cortina Asset Management, which is based in Milwaukee, Wisconsin, and covers the United States market, Tokyo-based Sparx Asset Management in the Japanese market, and Edinburgh-based Munros Capital Management, which invests in European small caps. Investments are spread over the three funds in equal weightings.

Pengana's Asian exposure is through Sparx, a fund that limits its investment horizon to the Japanese market. This is arguably a narrower focus than the mandate allows, but Griffith says the importance of an exposure to Asian small caps should not be overstated, as they remain a relatively modest part of the total market capitalisation of



NICK GRIFFITH

global small companies. "They are probably only a few per cent," he says.

Having said that, the heavy losses of the Asian markets during the financial crisis have created some interesting opportunities, he says. "An allocation to Asia makes a lot of sense. The Asian markets have fallen by 70 per cent, while the US markets have fallen by 50 per cent. So Asia has actually fallen by more, but really doesn't face a lot of the same issues that the US faces," he says.

To capitalise on these opportunities, Pengana is looking to add a fourth manager in Singapore. "[The fund] will focus on the Asian markets outside Japan: Taiwan, Korea, China and to a degree Singapore and Hong Kong," Griffith says.

He does not want to reveal the name of the fund manager yet, but says it has performed relatively well during the financial crisis compared to the markets.

Pengana opened an office in Singapore at the end of last year and has three investment professionals on the ground. The Singaporean fund manager was recommended to him by another manager that has recently closed for business. "This group we found in Singapore ticks all the boxes," Griffith says.

Before he takes on a new manager, there are many boxes to tick. "We look for bottom-up, fundamental stock pickers, as opposed to a quant or thematic manager. We look for managers who focus on the companies themselves and do a lot of independent research," he says.

"[The small-cap market] is a very under-researched area of the market, the depth of research is not good. You need to take the

FOCUS

Standard & Poor's (S&P) rates the Pengana Small Companies Solution three stars, reflecting its conviction that risk-adjusted fund returns can meet relevant investment objectives and be in line with returns of peer funds.

S&P views Pengana's qualitative assessment of managers as sensible, focusing on the investment process and expertise in this segment of the market, but also taking into account structural issues.

The portfolio is equally weighted to three regions: the United States, Europe and Asia, with the manager stating the correlation benefits gained from using regional weights and the move away from a market cap approach to construction are more effective in capturing the small-cap risk premium. S&P recognises the merits to this approach to constructing a global small-cap portfolio. That said, it would like to see a broader use of regional managers in the Asian segment of the portfolio.

Source: Standard & Poor's

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time to research companies.”

Griffith also looks for managers that have a balanced approach to the growth and value characteristics of a company.

He favours specialist, small fund managers with low levels of assets under management.

Griffith also prefers when managers have an equity ownership in the business.

But no matter how carefully you have chosen your small-cap managers, the industry has seen sharp declines in share prices during the crisis. The industry's higher risk profile makes it one of the first areas where investors pull out their funds. As a result, inflows have dried up, and Griffith expects this will remain the case for the next three to six months.

"The riskiness in the markets will be maintained for the foreseeable future, but I think the end of this year, the third and fourth quarter, will potentially be a sensible entry point," he says.

PENGANA SMALL COMPANIES SOLUTION

Net performance as at 31 March 2009	1 MTH	3 MTH	1 YR	SINCE INCEPTION (NOV 2005)
Total return (%)	+4.3	-7.3	-42.3	-16.5

Source: Pengana Capital

16

IFA ISSUE 456