SHINING A LIGHT ON……
ALLIANZ BRIC STARS FUND

At a glance

The Allianz BRIC Stars Fund was launched in 2006 and for a few years delivered investors with above average returns (from launch in February 2006 to the end of December 2009 it returned 68.44% against a benchmark of 40.5%).

However, as Russia, India, Brazil and China have slowed so the performance of the fund has fallen away. (Between 1 January 2010 and 30 April 2014 the fund was down 23% against a benchmark which is down 14%).

For us it highlights the dangers of investing in specific areas within emerging markets especially if the managers remit restricts them from growth outside of the region. The original manager was Michael Konstantinov and he was replaced in 2013 by Kunal Ghosh.

At the same time the investment remit of the fund was changed so the fund had the potential to invest 33% outside of non BRIC economies. Clearly the managers still believe in the BRIC story but want the flexibility to invest in other economies if they see opportunities. However, investors holding assets in emerging markets and Asia will already have access to these economies albeit smaller and surely this is no more than another Emerging Markets Fund but with limited investment powers.

We can't say the fund has had strong performance because it is too early to say however the new manager has a strong record in investing in emerging markets.

In the update we will share some of the thoughts from the manager.

Who are the team behind the fund?

The lead manager is Kunal Ghosh. Kunal was brought in in an effort to revive the fortunes of the fund. He has been with Allianz since 2006 and heads up an eight strong emerging market team. The fund itself has significantly underperformed over the last five years and seen the value of assets held fall by over 60%. In comparison he has shown considerable success with the emerging market fund he manages.

What is the story behind the investment?

Frontier and emerging markets potentially offer a compelling investment case.

Asia's population of 4 billion people is growing by 1.5% a year (with an average age of 30). Africa's population of 1 billion people is growing by 2% a year (with an average age of 19). By contrast the developed world population of 1 billion people is growing by less than 1% a year (with an average age of 45).

This younger working population contributes positively to the economy; for example Brazil and India have high ratios of working age people to retired people (the bulk of India's population is under 44). In the US, for example, they do not have sufficient workers paying taxes to provide entitlement programmes for the retired.

China is pivotal to emerging markets as are India, Russia and Brazil. These economies outspend the US (which on its own accounts for 25% of the world's spending) and the gap will grow.

Average earnings in China have grown by 300% in 10 years and wealth is being distributed to a growing aspirational middle class. Growth in 2012 and 2013 was 7.7% and is expected to be 7.4% in 2014.

Fundamental reforms are now being adopted which include private investment in state controlled industries, reversal of the one child policy, freeing up of interest rates, improving treasury yield curves and the ability for qualified private investors to set up small to medium sized banks. These reforms will take time; probably decades.

Other BRIC countries are struggling; India's economic growth fell below 5%, Brazil's growth is negative and Russia just 1.3%.

Brazil benefits from Chinese demand for natural resources. The Brazilian mining company, Vale, is the world's largest iron ore exporter and China is its biggest customer. It is one of the few countries in the world self-sufficient in oil and has the largest farmable land in the world. Brazil is becoming the world's leading sugar, coffee, beef and chicken exporter. Combined with Argentina, the two are the world's biggest soybean producers.

Resource rich economies including Qatar, UAE and Saudi Arabia have seen significant stock market rises through companies in the construction and retail sectors.

Qatar and UAE have progressed to a point where they are being upgraded from frontier to emerging status. Having invested heavily in infrastructure (reminiscent of China in the 2000s) - high speed bullet trains, airports and other new infrastructure projects have opened up the centre of the country. Qatar grew by 5% in 2013 and UAE 4%.

Saudi Arabia's economy (the largest in the Middle East) grew on average by 5.9% p.a. over the last ten years. It rose over 60% from the previous 10 year average and faster than the global average growth of 3.8% (Source: IMF).

Dubai will sponsor World Expo 2020 enhancing its position as a financial gateway between the East and the West. The economy is set to grow by 6.4% p.a. over the next three years.

Kenya and Nigeria are attractive frontier economies with the young populations, increasing consumer spending power, fast growing GDP, and low government debt. The average earnings are around $1,300 per capita.

Nigeria is prioritising infrastructure which will open up roads and create a national electricity grid, which follows the likes of China, Qatar and UAE.

In summary, with younger, more dynamic economies which are growing emerging economies have the ability to dominate the 21st century, as the US did in the 20th.

Fund highlights?

Listening to the manager and reviewing the documents on the fund although the investment philosophy seems strong the unanswered question is why invest in a BRIC fund and not an emerging market or Asia fund which would give similar access.

The manager, similar to other emerging market managers, believes that as these equities have fallen out of favour with investors this has opened up significant opportunities. Aligned with a growing consumer base this offers investors fantastic opportunities the challenge is when (along with any investment).

The fund has been rebalanced to move away from export driven to consumption driven stocks as Kunal believes that this is where the growth will come from going forward. Looking at the arguments for emerging markets this is a very strong case.

The team looks at investments through a behavioural finance lens, believing that markets react inefficiently to events and so hope to exploit price anomalies where the potential for positive change has been ignored.

The number of holdings is 64 with the top ten having similar weightings around 3 to 4%. Listening to the manager and looking through the notes there is nothing that really makes the fund stand out from an emerging market fund. The manager can allocate a third of the fund outside of BRIC and it feels that this is no more than a restricted emerging market fund.

Investors who feel that these economies will be the dominate players in the future may well favour this fund but there are emerging market funds that already have high weightings to the likes of Brazil and India and it is therefore a consideration as to whether they will better serve the investor.

Clearly the manager has a good track record in emerging markets with his US fund and although this doesn't provide a country specific breakdown it does appear to favour emerging Asia, Europe and Latin America and therefore we suspect there will be some stock overlap.

In summary there doesn't feel like there is anything with this fund that investors couldn't get with an emerging market fund which would diversify their risk. There is no real track record of performance and therefore even this cannot be taken into consideration. It therefore may only appeal to those who believe these economies will be the drivers of the future and feel that other funds cannot give them that access.

Fund performance

The table below shows performance since 2009 and going into 2014:

	2009	2010	2011	2012	2013	2014	Since Launch
Allianz BRIC Stars Fund	84.79%	13.11%	-27.63%	6.03%	-4.07%	-4.01%	34.39%
iShares MSCI Emerging Markets (Inc)	54.30%	21.85%	-20.53%	9.50%	-7.31%	-3.36%	33.53%

You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well as rise. The total return reflects performance without sales charges or the effects of taxation, but is adjusted to reflect all on-going fund expenses and assumes reinvestment of dividends and capital gains. If adjusted for sales charges and the effects of taxation, the performance quoted would be reduced.

Conclusion

Investors would have done little better buying a fund which trackers the index. Although the manager took over in 2013 the fund hasn't significantly outperformed the index and this may take time to come through. The question for investors is when emerging markets comes back into favour will investing in these areas drive the greatest returns.

The source of information in this note has been provided by Allianz and is correct as at May 2014. These are notes from meeting the fund manager or representative and should not be seen as a recommendation to purchase any fund mentioned. Any reference to shares is not a recommendation to buy or sell. Should you wish to make a decision based on these notes we cannot take responsibility for this and you should carry out your own research before making a decision. You should note that past performance is not a reliable indicator of future returns and the value of your investments can fall as well rise.