

# Knowing the World Thoroughly

**U**nlike other funds, the Global Emerging Markets Fund has a flat structure, where managers are deeply involved in investing activities and less in administrative issues. The fund capitalizes on the pricing inefficiencies and lack of coverage of the emerging markets by thorough fundamental research and regular company visits. An emphasis on risk management is another key characteristic of the fund.

**Q:** Would you describe your investment philosophy?

**A:** We are a dedicated emerging markets fund. Emerging markets seem attractive because they are inefficient relative to developed markets in terms of pricing. The inefficiency is a function of the quality and quantity of the coverage of these markets and of the relative lack of research in the marketplace.

We feel we can add value by choosing stocks and by identifying the best opportunities in the emerging markets through a thorough, disciplined and research based process. We run focused portfolios of less than 60 stocks with a target minimum position size of 1%.

We are active managers, so we do not feel obliged to be in any particular sector, country or stock. For example, if we do not find any interesting stocks in Russia or Korea, we do invest there. There is no top-down allocation. Our restrictions come solely from our risk budget, but it is a relatively generous risk budget.

**Q:** When you search for stocks around the world, do you place higher importance on historic earnings, value, or growth discipline?

**A:** We look purely at the fundamentals. We try to model and predict cash flows and earnings. It is very much value-based investing with a forward-looking emphasis.

**Q:** What are the cornerstones of your investment process?

**A:** The starting point is the portfolio and other stocks that are on its fringes, which are companies that are deemed to be interesting for the portfolio. At any given time, we have 50 to 60 stocks in the portfolio, and our team of six covers a total of 250 to 300 stocks on our radar screen.

Our objective is to find out what are the best stocks for the portfolio. The most attractive stocks are those that have the highest differential between the price target and the current share price. We try to pick the 50 or 60 most undervalued stocks in our emerging

## Fund Facts

Symbol	GEMFX
Website	<a href="http://www.usfunds.com">www.usfunds.com</a>
Address	U.S. Global Investors 7900 Callaghan Rd. San Antonio, TX 78229
Tel. No.	800-873-8637
Inception	02/24/05

## Portfolio

Total Net Assets *	\$ 10.8
Avg Mkt Cap (\$ Weighted) *	\$ 2,020
Average Price/Earnings Ratio	10.2
Average Price/Book Ratio	1.7
Turnover Ratio	29.97 %

## Investment Information

New Investment	Open
Min Initial Investment**	\$ 5,000
Min Subsequent Investment	\$ 0.00
Min Initial IRA Investment	---

## Risk (Against S&P 500 - 3 Years)

Alpha	N/A
Beta	N/A
R-Squared	N/A
Ann Std Deviation	N/A
Sharpe Ratio	N/A

## Fees and Expenses

Max Sales Charge - Front	0.00 %
Max Sales Charge - Deferred	0.00 %
Max Redemption Fee***	2.00 %
Total Expense Ratio****	2.00 %

## Portfolio Manager

Team Managed	---
--------------	-----

\* millions

\*\* The fund also offers an ABC Investment Plan that allows \$1,000 initial payment and a monthly investment minimum of \$100

\*\*\* if exchanged within the first 180 days

\*\*\*\* annualized as of June 30, 2005

Data through: 06/30/05

Source: Company Documents; Lipper



**TICKER'S Choice**

markets universe. From a portfolio construction perspective, our job is to ensure that the list is consistent with the risk parameters of the portfolio.

The list is constantly renewed as companies may go out of our research list because of changes in strategy, or new companies can be added based on information acquired from traveling and meeting competitors, for example.

We meet the management of companies in Asia, Latin America, Eastern Europe and Africa four times a year to refine and update our price targets. Since we are familiar with the companies, we ask the managers very specific questions. We define where we stand relative to the previous meeting and get back to our spreadsheets to update our forecasts. The modeling then leads us to refine our price targets for each stock.

It is a very fundamental, hands-on and research-driven. Then we compare the revised share price to the current share price. We want to ensure that the most undervalued stocks on a risk-adjusted basis are the ones that we include in our portfolios.

Because of the price target approach, we are not catalyst-driven or trading-oriented. We typically have low portfolio turnover and a holding period of around a year, which is relatively long for emerging markets. The idea is to hold the stocks until there is a better idea, until the investment case changes, or until the position becomes inconsistent with our risk budget.

**Q:** *What is unique about your research process?*

**A:** We do not differentiate between the stock selection process and the research process. We do not have separate analysts to do it for us. We, the managers, do it ourselves so it is a manager-driven process. Often in larger investment management companies the buy-side analyst acts as a filter between the manager and the companies in which he is investing. As a function of the size and complex-

ity of these businesses, the senior managers may spend most of their time in internal meetings and business affairs as opposed to researching companies. In our company, we have a flatter approach and the managers themselves are visiting the companies. Research is only the first part of the investment management process.

**Q:** *How do you approach risk management?*

**A:** The portfolio as whole has to be satisfactory from risk-management perspective. Risk is something to be managed and to be aware of, but is also something to be embraced. Making money is about taking and managing risk, so we have stocks that have a high marginal contribution to risk within the portfolio but we make sure that we are aware of the risk characteristics. Even though we are bottom up investors, we are not betting the house on a particular strategy or theme, or country, or sector.

We use a risk management system, which tells us what is the overall risk of the portfolio, what the individual profile of each stock is and how much risk it contributes to the portfolio. Our risk manager is not in the middle office or back office: he is an integrated part of the portfolio team.

**Q:** *When you select securities, do you compare them to similar companies in other markets across the world, or only to companies in their own market?*

**A:** We have a strong bias towards intra market comparisons. For example, if we are looking at a beer company in Brazil, we will look at the valuation of other consumer stocks in the Brazilian market. We do not like the cross-border market comparisons because they are usually misleading. For example, if you compare a Korean electronics company to a Taiwanese electronics company on a historic basis, the Korean market is consistent-

ly cheaper than the Taiwanese market and probably it will always be.

You can make theoretical arguments about it, but I would rather take the world as it is. Our starting point is looking at individual stocks in similar sections of the same market. If that information is not available, we look at how the stock has behaved over time relative to its own market. For example, if GE typically trades at a 20% premium to the S&P and then GE suddenly starts trading at 60% premium, this could be a sell signal for GE, but we would not typically think how GE compares to Samsung.

**Q:** *On average, in how many markets do you invest and is there an index that you use for benchmark?*

**A:** We are looking through the whole global emerging market universe, which is quite large. The vast majority of our money is invested in nine major emerging markets: two Latin American markets, Mexico and Brazil: in Asia - India, Taiwan, mainland China, Korea, and then Russia, Israel, and South Africa. Our benchmark is the MSCI Emerging Markets Free Total Return Index, which includes dividends.

**Q:** *What are the peculiarities of investing in markets like Russia?*

**A:** The Yukos affair was political. In the headlines over the last couple of years, it is an interesting case study for us, because we actually had a position in the stock. We exited it purely on valuation grounds and in retrospect we were lucky. But even if we had not exited it earlier, as soon as the fate of Yukos shares ceased to be an economic issue and became a political issue, we lost our edge in terms of the ability to analyze the stock.

If we do not understand what is going on in a company and how the stock can be valued, we get out of it. Once the whole thing started unravel-

ing, we would have sold if we still had stock. Some investors looked at it in 2004, because it was trading at significant discount, but we would never invest in a company on these terms. We are not political analysts, we are fund managers. That is an example of investing not only on the basis of valuation, but also on conviction on what our edge is.

**Q:** *Can you give us an example of what makes unique the Asian markets?*

**A:** Each country is different. At any one time, valuations are different, but you can find a bank in Korea that trades one times book and a bank that trades at two times book, and maybe there is no reason. Some oil companies in Korea trade at 4 times earnings, others trade at 6, and those are the types of valuation anomalies that we look for.

One of reasons that the Korean market is cheap is because the companies have historically been asset destroyers, for the lack of a better word. Their dividend-payout ratio has been poor. But in the past 4-5 years, there have been some changes because companies starting to pay dividends to shareholders, increasing their efficiency, and are becoming more focused on return on equity. Before the Asian crisis in 1997 – 1998, Korea's focus was on sales growth and market share, somewhat like the Japanese 1960 model. But now things are changing and foreign ownership has risen from zero 20 years ago to 41% today.

India has a relatively closed economy. However, a lot of companies are making very competitive products there now. It is a very rich and deep market in terms of the number of stocks. The macro side is slowly improving, which is good news for the longer-term.

**Q:** *Many people think that China is also repeating the Japanese model and*

*could end up in the same situation. Do you find the same story in China as in Korea?*

**A:** Yes, we are looking for the same thing – our interests to be aligned with that of the management. If the company is there as a strategic trophy for the government, or is listed

**“Our job from stock investing perspective is to pick the 50 or 60 most undervalued stocks in our emerging markets universe. From portfolio construction perspective, our job is to ensure that the list is consistent with the risk parameters of the portfolio.”**



about

**Julian Mayo**

**Julian Mayo** joined Charlemagne Capital in August 2003 as a Director of Charlemagne Capital (UK) and a member of the Portfolio Management team. In 1983 Julian began his investment management career in Hong Kong with Schroders Asia before joining Thornton Management (Allianz Dresdner Asset Management) in Hong Kong in 1985. He then opened Thornton's Tokyo office in 1987, moving to London in 1991. In 1996 Julian joined the Regent Pacific Group as Director of Product Development. In 1999 he returned to Asia as Managing Director of Regent's Hong Kong office responsible for portfolio management. Julian has a BSc in Economics from Bristol University.

as a cash cow for its parent company or for some other subsidiary, that is not what we are looking for. Understanding the corporate structure and the alignment of our interests with the aims of the company is very important for us.

**Q:** *How do you deal with risks that are inherent for the emerging markets, such as currency volatility and liquidity?*

**A:** We have a strict liquidity rule as part of our risk management process. We have to be able to exit at least 75% of our portfolio within a week, without representing more than a third of the volume over that week. We do not have a policy to hedge currencies so investors take local currency risk. From the point of an U.S. investor, emerging currencies as a whole are undervalued so should see currency appreciation against the dollar. But we are not currency experts, so we do not hedge currency.

**Q:** *How do you try to protect yourself from fraud, which we have seen in Russia, Mexico, or Korea?*

**A:** The stock selection process includes a rigorous analysis of the management. We cannot say in advance and with full certainty that fraud is not going to happen, but we meet management quarterly and we follow these companies more closely than a lot of our peers. Even the top investment banks do not have the most experienced analysts covering the emerging markets area. We have known many companies for over a decade. Knowing the company for a long time gives us an edge and more confidence. It is easier to spin your story once than to do it repeatedly. But we are not always right. It can happen that someone you thought you could trust ends up to be some kind of a fraud, but luckily for us it rarely happens. ■

**TICKER Staff**