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HEAD TO HEAD: Somerset Capital Management's Dominic Johnson

By Chris Kennedy

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InvestorWeekly's Chris Kennedy speaks to Somerset Capital Management's chief executive, Dominic Johnson, about what it takes to run a successful boutique and the key issues to look at in emerging market investing



Somerset Capital Management is a UK-based boutique asset management firm specialising in emerging markets. The company makes regular visits to Australia to meet with current and potential investors, and is currently looking to attract funds into its Dividend Growth fund.

IW: What's important when you're investing in emerging markets?

DJ: Nothing's in a straight line; everything is constantly changing. When I started out, Greece was an emerging market, Argentina and Venezuela were very investible markets, and Egypt was a fantastic market. You're looking at a constantly changing bag of markets but at the core of it is an astonishing shift in GDP activity and personal consumption from people who can just about afford subsistence to people who are looking to buy their first moped, their first car, their first mortgage. These are huge shifts in consumption patterns.

China is finding it very difficult to compete due to wage growth so we're seeing a cycle of outsourcing. We like frontier markets because they're benefiting from this, it's one of the reasons Bangladesh and Laos are looking very attractive for us. It shows you the problem China has - it's expensive now. That's the issue, it's inflation.

IW: How would you describe your investment style?

DJ: We're an active bottom-up manager. Active management reduces risks in emerging markets. You pay a bit more for it but I think it's worth it. We are experts in smaller company investing and it's wonderful to unearth stocks that are high quality, are paying dividends and are well managed and are unknown by the market - it's really attractive for us but it's very hard to do that in developed markets.

The smaller company asset class is very different in emerging markets from developed markets - they are more established. Developed market small caps are often heavily geared and the manager is inexperienced. In emerging markets you get a wonderful bag of companies that are slightly cheaper than the mega caps but with management that's been around for a long time.

IW: Do you run a concentrated portfolio?

DJ: We have conviction portfolios. In emerging markets your risk is not knowing your stocks, it's the surprises, it's corporate governance. You have to do your research on the companies and we think it's better to have a more concentrated portfolio than [a] less [concentrated one]. You get diversification with 40 stocks and you have to know them well. You need to take a very long-term view.

We spend a lot of time on research, we visit all the companies we invest in, it is important but it's not the most important aspect. It's an additional level of due diligence. The peer reviews are important; the whole point is [to] reduce risk.

IW: Do you take macro factors into account?

DJ: We do look at the macro, but only in so far as it helps us understand the stock and reduce risk. We're bottom-up investors, not macro investors, and our mistakes historically have always come when we've tried to bring the macro to bear too much.

IW: What is the key to running a successful boutique manager?

DJ: A stable team is important in a boutique. If you change the team in a boutique you change the core experience. You have to have a lot of integrity when it comes to capping the assets you have. Emerging markets don't have unlimited capacity; if you want a good manager you cannot have one that runs too much money. If you manage too much capital you end up distorting your process - you become a fundraiser rather than an asset manager.

IW: So how hard is it to keep a lid on the asset levels?

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DJ: The only way you can run a capacity-constrained business is if you own it. External shareholders will always be interested in growing assets. We're incentivised to keep our clients and have low turnover rather than have too much money. I also have to report to major clients once a year via our Advisory Board, so transparency helps.

IW: So, at what point will you think about capping capacity in your fund?

DJ: I think we can probably manage \$2 billion to \$3 billion [in the Dividend Growth fund]. If you compare that to our peers in similar types of strategies, I think it differentiates us quite substantially. The Dividend Growth fund currently has about \$100 million so it's a long way off closing, but it can happen quite quickly - we've been getting great traction in Australia. You only really need a dozen good investors.

IW: So there's demand for your funds in Australia?

DJ: I've been here for three days and we've had some really good responses. I think people are having trouble with emerging markets. What we're doing with the low volatility profile and our approach to emerging markets is going down very well.

IW: Are the majority of investors UK-based?

DJ: Canada and Australia are big representatives overall. We manage \$2.5 billion overall in various emerging market strategies. Probably half of our business is North American - Canada has similar dynamics to Australia. Australia represents about 10 per cent of our business but I'd like to grow that to 20 per cent over the next few years.

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