Featuring Pheim Asset Management (Asia)

Award-winning FUNDS

The missing pieces for your investment portfolio?

smartinvestor

The definitive guide to unit trusts for investment professionals, financial advisers and investors

NAVIGATOR - CHANGE THE WAY YOU **INVEST**

Growing Pheim&Recognition

Boutique fund management outfits may be smaller in size and scale than the larger global fund managers, but this does not necessarily mean higher risks and lower returns for investors. In fact, Pheim Asset Management (Asia) has proven that it is possible to deliver consistent performance and above-average returns without taking on higher risks.

By Timmy Tan

Every once in a while, a fund may be on a winning streak and be fortunate enough to rank tops in performance as compared to its international peers. But how can one explain a fund's ability to be consistently ranked ahead of its peers in terms of returns every year over five years? That is exactly what the Pheim ASEAN Emerging Companies Growth Fund (PAEC) has achieved from 1998 to 2002. Classified in the offshore ASEAN equity funds category, the PAEC Fund has been ranked number one by Standard & Poor's over one-, two-, three-, four- and five-year periods.

Over that five-year period, the PAEC Fund returned a whopping 80% while the fund in second place lost 19% over the same period. Simply put, the PAEC Fund generated an additional 80 US cents for every dollar invested, which is close to doubling one's investment over that five-year period.

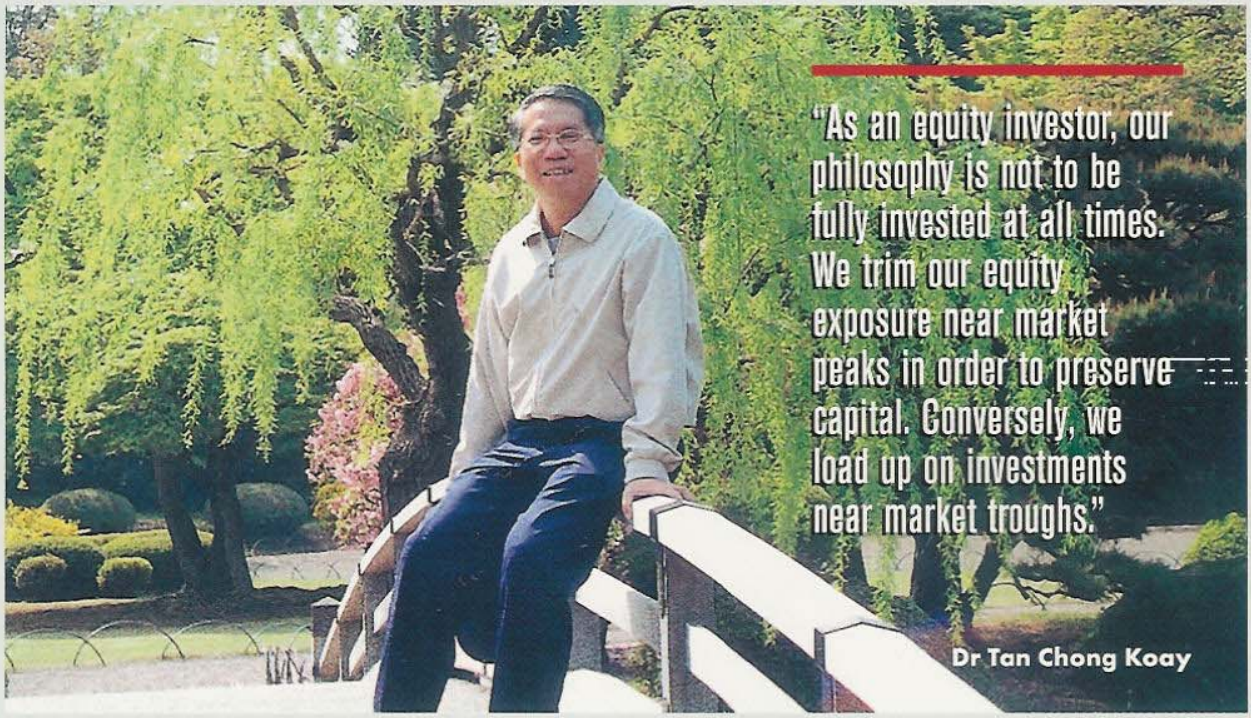
And while it is true that the PAEC Fund posted a negative return of 2.6% during the three-year period from 2000 to 2002, one must note that the second-placed fund posted a negative return of 35%. This means that a unit holder in the second-placed fund would have seen his investment deteriorate by more than a third. On the other hand, a unit holder of the PAEC Fund would have experienced a relatively minor loss.

The PAEC Fund has done more than just outperform its peers, outpacing their returns by a wide margin over all the time periods surveyed. Even during the two-year period from the beginning of 2001 to end 2002, the PAEC Fund generated a return of 25% while the second-placed fund recorded a negative return of 7%.

Equity ASEAN

Equity ASEAN Bid-to-bid in US$	One-year period 31 Dec 2001 to 31 Dec 2002	Rank	Two-year period 29 Dec 2000 to 31 Dec 2002	Rank	Three-year period 31 Dec 1999 to 31 Dec 2002	Rank	Four-year period 31 Dec 1998 to 31 Dec 2002	Rank	Five-year period 31 Dec 1997 to 31 Dec 2002	Rank
Benchmark – FTSE All-World Asean (US$)	-1.97%		-15.60%		-38.20%		-3.98%		-4.58%	
Pheim ASEAN Emerging Companies Growth Ltd	17.70%	1	24.87%	1	-2.58%	1	59.81%	1	79.90%	1
Fidelity Funds ASEAN	0.18%	6	-12.43%	11	-44.37%	7	1.08%	2	-18.82%	2
FPIL INVESCO GT Asean	-6.69%	9	-8.88%	6	-49.30%	8	-20.12%	10	-27.76%	8
Hansard EU\JF Asean Trust	5.18%	3	-7.43%	4	-38.41%	3	-4.89%	5	-43.62%	11
Hansard EU\INVESCO GT ASEAN	-4.43%	7	-10.62%	10	-49.93%	9	-21.59%	12	-27.82%	9
Hansard\JF ASEAN	5.78%	2	-9.59%	8	-39.61%	4	-3.42%	4	-41.32%	10
INVESCO GT ASEAN A	-5.57%	8	-7.31%	3	-51.01%	10	-17.57%	8	-22.39%	3
JF ASEAN	4.29%	4	-6.65%	2	-41.48%	5	-0.46%	3	-24.53%	5
Jupiter Archipelago	-10.55%	12	-19.74%	12	-35.05%	2	-15.40%	7	-25.06%	6
Royal Skan $ INVESCO GT ASEAN	-7.12%	11	-9.70%	9	-52.27%	12	-21.26%	11	-26.08%	7
Royal Skan £ INVESCO GT ASEAN	-7.03%	10	-9.43%	7	-51.77%	11	-20.07%	9	-23.85%	4
ZI JF ASEAN Trust	2.52%	5	-8.52%	5	-43.07%	6	-10.95%	6	N.A.	NA
Mean/Count	**-0.48%**	**12**	**-7.12%**	**12**	**-41.57%**	**12**	**-6.24%**	**12**	**-18.30%**	**11**

Source: Standard & Poor's



It is also worth noting that the fund which takes second spot invariably differs from one year to the next, so the PAEC Fund is consistent as well as being a winner. Managed by boutique fund management outfit Pheim Asset Management (Asia) Pte Ltd (Pheim Asia), the superior outperformance boils down to strategic asset allocation and sound stock picks without taking on unduly high risks, says Dr Tan Chong Koay, founder and chief executive of Pheim. The strategy sounds academic but investing is more an art than a science. And, like it or not, Pheim has definitely proven to be worth its salt by outperforming the global players in its category.

In fact, according to investment consultants Watson Wyatt, Pheim Asia has outperformed its respective benchmarks every year for all accounts for the last eight consecutive years ended December 2002. Not only that, Pheim Asset Management Sdn Bhd (Pheim Malaysia) has also outperformed for all its Malaysian mandate accounts combined every year for the nine consecutive years ended December 2002. The reports even concluded that Pheim Asia and Pheim Malaysia have performed better during periods when the overall market was experiencing negative returns.

Making a fortune

But does a boutique fund manager such as Pheim have what it takes to take on the bigger players? "Fund sponsors often prefer to appoint well known and established fund managers since this enables them to feel more comfortable with their decisions," say Watson Wyatt. "However, as Warren Buffet said, the seeds of a fund manager's failure lie in its own success, and experience has shown that the performance of these larger managers is often far from satisfactory, leading to considerable disappointment for fund sponsors."

According to investment consultants Watson Wyatt, Pheim Asia has outperformed its respective benchmarks every year for all accounts for the last eight consecutive years ended December 2002.

One important differentiating factor between a boutique fund management outfit and a larger global one is that the former is typically owner-managed. While the boutique fund manager may generally be managing a smaller fund than a larger global one, what he does have, typically, is more flexibility in terms of execution and seizing investment opportunities. The larger firms may have economies of scale but they also have to grapple with bureaucracy, differing investment styles and philosophies because of the many investment managers, not to mention the possibility of changes to management personnel.

Under the leadership of homegrown fund manager Dr Tan, Pheim has shown its ability to deliver consistent results. Between 1995 and 1996, Dr Tan successfully generated RM40 million (Malaysian ringgit) in gains from an investment of RM25 million. His investment targets were entities listed on the second board of the Kuala Lumpur Stock Exchange (KLSE), small-and

medium-capitalisation companies that are generally not on the radar screens of the larger fund management outfits because of their failure to meet certain investment criteria. The results not only earned Dr Tan the nickname "King of the Second Board", they also demonstrated the flexibility and capability of a well-managed boutique fund.

Indeed, Pheim's track record has been backed by a remarkably long list of accolades that dates back to 1995. Not surprisingly, Pheim Malaysia's Malaysian Emerging Companies Growth Fund (with its fund size of between US$60 million and US$90 million back then) was ranked first by Micropal in both 1995 and 1996 in the offshore Malaysia Country Funds category. Even the Alliance First Fund, of which Pheim Malaysia is the external investment manager, has topped its peers in the balanced income funds category in Malaysia for the one-year period in both 1998 and 1999, the three-year period in 2000 and the three- and five-year periods in both 2001 and 2002.

Market timing

What truly differentiates Pheim from most others is its strong focus on small-to-medium cap companies. In Singapore, winning picks include **Hyflux** and **Food Junction**, stocks that appreciated by more than 300% and 200% within a year and a half of Pheim Asia's initial investment.

So what is the secret behind one of Asia's amazing financial wizards? "Our recognition stems from our structured and proven investment philosophy, investment processes, operational procedures, a strong investment team and staff integrity, as well as an extensive network of contacts," says Dr Tan.

"As an equity investor, our philosophy is not to be fully invested at all times. We trim our equity exposure near market peaks in order to preserve capital. Conversely, we load up on investments near market troughs. We believe that strategic asset allocation complemented by good stock picks are key to superior outperformance without taking on unduly high risks."

Indeed, during the peak of the Asian crisis, 60% to 80% of Pheim Malaysia's net purchases in Malaysian equities were made between July and October 1998, around the time in early September when the Kuala Lumpur Composite Index (KLCI) reached its lowest point. "Our focus then was on companies with strong cash flows, low gearing and sound management. By

SMART TIPS: Stock Picking

Factors to consider in the stock selection process:

Quantitative factors

- Strong balance sheets (i.e. low gearing and strong cash flows);
- Positive earnings dynamics (i.e. strong earnings growth, dominant market position and strong pricing power);
- Attractive financial ratios like low price-earnings ratios, low price-to-book valuations and high margins; and
- Understanding trends that affect the company and its major turning points.

Qualitative factors

- Focused and experienced management (i.e. high integrity, capable and significant equity ownership interest);
- Operational transparency; and
- Good corporate governance.

"In an academic world, it is easy to speak of stocks that possess all the qualities above. However in reality, such a stock is hard to find especially during good times. If one does exist, it is a rare gem indeed. That is why investment management is to a great extent an art to be desired and envied," says Dr Tan Chong Koay.

Equity ASEAN: Tracking Error

Equity ASEAN Tracking Error Benchmark – FTSE All-World Asean (US$)	One-year period 31 Dec 2001 to 31 Dec 2002	Rank	Two-year period 29 Dec 2000 to 31 Dec 2002	Rank	Three-year period 31 Dec 1999 to 31 Dec 2002	Rank	Four-year period 31 Dec 1998 to 31 Dec 2002	Rank	Five-year period 31 Dec 1997 to 31 Dec 2002	Rank
Pheim ASEAN Emerging Companies Growth Ltd	11.29	1	15.60	1	14.05	3	15.32	3	15.77	9
Fidelity Funds ASEAN FPIL INVESCO	1.95	12	4.02	12	7.44	12	8.58	12	15.60	10
GT Asean	7.19	7	9.15	8	14.26	2	14.65	4	23.04	3
Hansard EU\JF Asean Trust	7.60	4	9.69	5	11.63	7	19.87	1	32.39	1
Hansard EU\INVESCO GT ASEAN	8.08	3	11.56	2	15.28	1	15.50	2	21.57	4
Hansard\JF ASEAN	7.43	5	8.56	9	11.63	8	13.27	5	28.26	2
INVESCO GT ASEAN A	7.16	8	9.56	6	11.67	6	11.36	9	16.95	8
JF ASEAN	6.40	11	7.07	11	8.10	11	8.70	11	20.16	5
Jupiter Archipelago	9.31	2	10.48	3	10.60	9	11.28	10	14.96	11
Royal Skan $ INVESCO GT ASEAN	7.42	6	9.27	7	12.41	5	12.82	7	19.25	7
Royal Skan £ INVESCO GT ASEAN	6.84	10	9.83	4	12.52	4	13.12	6	19.83	6
ZI JF ASEAN Trust	6.92	9	7.66	10	9.21	10	11.54	8	N.A.	NA
Mean/Count	**7.30**	**12**	**9.37**	**12**	**11.57**	**12**	**13.00**	**12**	**20.71**	**11**

Source: Standard & Poor's

Equity ASEAN: Information Ratio

Equity ASEAN Information Ratio Benchmark – FTSE All-World Asean (US$)	One-year period 31 Dec 2001 to 31 Dec 2002	Rank	Two-year period 29 Dec 2000 to 31 Dec 2002	Rank	Three-year period 31 Dec 1999 to 31 Dec 2002	Rank	Four-year period 31 Dec 1998 to 31 Dec 2002	Rank	Five-year period 31 Dec 1997 to 31 Dec 2002	Rank
Pheim ASEAN Emerging Companies Growth Ltd	1.74	1	1.19	1	0.76	1	0.86	1	0.83	1
Fidelity Funds ASEAN	1.10	2	0.39	6	-0.28	9	0.14	2	-0.19	2
FPIL INVESCO GT Asean	-0.66	9	0.36	7	-0.27	8	-0.29	8	-0.22	5
Hansard EU\JF Asean Trust	0.94	5	0.41	5	-0.01	3	-0.01	5	-0.29	9
Hansard EU\INVESCO GT ASEAN	-0.30	7	0.21	11	-0.27	7	-0.31	9	-0.24	7
Hansard\JF ASEAN	1.04	3	0.35	8	-0.04	4	0.01	4	-0.31	11
INVESCO GT ASEAN A	-0.50	8	0.42	4	-0.38	11	-0.32	10	-0.23	6
JF ASEAN	0.98	4	0.62	2	-0.14	5	0.10	3	-0.22	4
Jupiter Archipelago	-0.92	12	-0.20	12	0.10	2	-0.26	7	-0.30	10
Royal Skan $ INVESCO GT ASEAN	-0.69	10	0.31	9	-0.40	12	-0.36	12	-0.25	8
Royal Skan £ INVESCO GT ASEAN	-0.74	11	0.31	10	-0.38	10	-0.33	11	-0.21	3
ZI JF ASEAN Trust	0.65	6	0.45	3	-0.18	6	-0.16	6	N.A.	NA
Mean/Count	**0.22**	**12**	**0.40**	**12**	**-0.12**	**12**	**-0.08**	**12**	**-0.15**	**11**

Source: Standard & Poor's

coincidence, most were technology-related stocks. By the end of 1998, we had a huge overweight position in tech stocks," recalls Dr Tan.

So did Pheim suffer from the bursting of the technology and Internet bubble in early 2000? "At the height of the bubble in March and April 2000, we exited most of our positions primarily because we had already achieved returns in excess of 400% over a span of 18 months. After we cleared most of the tech stocks, we hardly made any further tech stock purchases that year," says Dr Tan. "Be invested at market troughs and sell during market highs. It is by staying true to that philosophy that our firm has been able to weather the difficult times."

Risk and returns

While the PAEC Fund is in a class of its own thanks to its outstanding performance, it also has a high tracking error over the one- and two-year periods from 2000 to 2002. Tracking error is a reflection of risk and it measures the standard deviation of the portfolio's returns above or below the benchmark. Is the PAEC Fund a high-risk investment option? "Tracking error would be more applicable to index funds or passive funds than actively managed ones. A fund may have a high tracking error but it could also be generating a high degree of outperformance. Does that mean it is a high-risk option? What if a fund generates stable returns but its benchmark swings wildly? This fund may be outperforming and yet would have a high tracking error despite the lower volatility as compared to its benchmark. Conversely, an underperforming fund with a high tracking error could be more risky," explains Dr Tan (see **How Risky is Risk?**).

Statistical measures should not be used in isolation, and any data that is used should be compared across the board. If another measure of risk, known as the information ratio is used, a different story emerges for the PAEC Fund.

The information ratio measures the fund's outperformance or underperformance relative to the benchmark, and the result is then divided by the fund's tracking error. The higher the ratio, the less risky the fund.

Based on data collated by Standard & Poor's, Pheim Asia's PAEC Fund has the highest information ratio in each and every year from 1998 to 2002. In other words, the PAEC Fund is deemed less risky than its peers. Some professionals in the industry have even gone so far as to assert that an information ratio of 0.50 is rated as "good", while 0.75 is "very good", and 1 is "exceptional".

Pheim's impeccable track record since its founding in early 1994 has demonstrated that boutique funds do have the competence in generating superior returns for their unit holders. And it need not necessarily come at the expense of higher risk. The data from Standard & Poor's is evident and it clearly compares Pheim Asia's PAEC Fund with other global institutional funds, not locally managed ones. "The industry-wide practice of outsourcing custody and fund administration functions to third-party professionals has allowed boutique fund managers like us to focus on managing the portfolio. It has also provided a safeguard to the customers' assets. We have a strong focus on performance," says Dr Tan.

Indeed, Pheim's strong performance was not built overnight and to maintain such an investment history is not an easy task. As a small-to-mid-cap specialist, it has shown its ability to invest in little known or under-researched companies and yet deliver sound and superior outperformance. Now if history is of any guide, Pheim is definitely on the right track. Do not forget that great investors like Warren Buffet also started out with a boutique fund and up until this day he still maintains an outstanding 38-year record. Si

How Risky is Risk?

Very often, fund managers tend to be evaluated based on parameters such as dispersion, volatility (standard deviation), tracking error and information ratio. However, it would be simplistic to use such statistics in isolation as some of these parameters have inherent weaknesses, so investors need a strong understanding of the way risk is measured before jumping to any conclusions.

Many investors on the street would naturally equate risk with the likelihood of losing money. This may not be wrong but it is somewhat simplistic. The investment profession has devised more sophisticated ways of quantifying risk and some of the more commonly used parameters include dispersion, standard deviation, tracking error and information ratio.

While they can provide a better basis for measuring and comparing risk, they are not without limitations and the results derived must therefore be interpreted with care.

Volatility and **tracking error** are common measures employed by investment consultants to quantify risk. Volatility is widely accepted to be the annualised standard deviation of the portfolio's return. A high volatility would imply that the portfolio's return fluctuates widely. However, it is only meaningful when compared using the same parameter of other portfolios.

The volatility of a portfolio is often compared to the volatility of an index. For example, if the volatility of the Straits Times Index (STI) was between 16% and 17% over the last year, any portfolio with a higher volatility of, say, 25% over the same period would then be classified as more risky than investing in the STI.

Tracking error is another measure of risk and can be more perplexing. It is defined as the standard deviation of outperformance or underperformance from the benchmark. Many would classify a fund with a high tracking error as one with high risks but that statement is more applicable to index funds or passive funds than actively managed ones. In general, many index-linked funds aim for a tracking error of less than 10%.

Investors often interpret a fund with a high tracking error as one undertaking a high level of risk, regardless of whether the funds is outperforming or underperforming. This is not quite right, because if investors encounter two funds with the same tracking error they will treat the fund that outperforms as if it is just as risky as the one that is underperforming. Tracking error is, therefore, a weak measure of risk to many because it does not differentiate between whether the fund is outperforming or underperforming.

An actively managed fund can achieve outperformance and yet have a high degree of tracking error. Take the hypothetical case of a fund that has been generating returns in the region of 10% while its benchmark has hovered around 1%. The tracking error would be high and the fund manager would be branded as 'high-risk'. But should the fund manager be "penalised" for creating value for shareholders? If, on the other hand, a fund has been generating returns of around 2% while the benchmark has risen by around 10%, the fund manager would likewise suffer from a high tracking error and be classified as 'high-risk' as well. However, this time he has failed to add value to his investors.

To many investors risk equates to "losing money". But there are better defined parameters.

This simple example illustrates the point that using such statistics in isolation can be misleading. Fund managers with a good track record of trimming their equity exposure near market peaks to preserve capital and

increasing their investments during market bottoms should be regarded as less risky. However, they could wrongly be branded as 'high-risk' ones just because of their high tracking error.

Based on the Nasdaq Composite Index, a person today who did not exit the tech sector at its peak in 2000 would be staring at capital losses of almost 75%. A fund manager who exited the market at the right time would have a high degree of outperformance, yet their tracking error would be high, so does this mean the fund manager should be categorised as 'high-risk'?

Fund managers with a good track record of trimming their equity exposure near market peaks to preserve capital and increasing their investments during market bottoms should be regarded as less risky.

The answer is no. The fund manager was able to preserve capital despite the collapse in technology shares. This is why investors have to be careful when using statistical parameters like tracking errors. A fund with a high tracking error and a wide margin of outperformance need not necessarily be a high-risk one, though an underperforming fund with a high tracking error is likely to be comparatively risky.

Information ratio is another measure of risk-adjusted returns. It measures the fund's outperformance or underperformance relative to the benchmark and this is then divided by the tracking error. The higher the ratio, the less risky the fund. Again, this ratio cannot be used in isolation – the fund's information ratio has to be compared against its peers. Si

Buying unit trusts

Thinking of purchasing a unit trust? Before taking the plunge, investors should consider the following pointers from Dr Tan Chong Koay:

Understand your needs and the reasons for investing

"Before investing, ask yourself what your investment time horizon is. The next things to consider are your investment objectives: Is it for capital appreciation or income generation? How about your risk tolerance, which is basically your ability to cope with capital losses?

Under present economic circumstances, it may be worthwhile for risk-averse investors to look at low-risk instruments like a balanced income fund or a fixed-income fund. Unless you are a long-term investor with an investment horizon of five years or more, a growth fund may not be suitable because of the volatility of the Asian markets. It is always wise to invest when the markets are depressed and sell when the market is excessively high and overvalued."

Know the investment manager

"Be aware of the investment manager behind the unit trust. Scrutinise the fund manager's track record and ensure that it is sound and consistent over the long-term.

Understand the fund's fee structure

"Be sure you know what the front-end fees and management fees are like and do check if the charges are exorbitant."

Investors should also be aware of the following risks:

Market risk

The value of one's investment in a unit trust will move up and down because of price fluctuations in the securities that the fund invests in. The movement in securities is influenced by many factors and these include changes in the economic, political and social environment.

Investment manager risk

If the fund manager of a particular fund leaves, the performance of the fund may be affected as well.

Interest-rate risk

Investors in fixed-income funds should ensure that the fund is not overly exposed to investments in long-term bonds because if interest rates rise then they will end up with substantial capital losses. It is not true that investing in high-grade bonds is "safe".

Specific risk

This refers to the individual risk of the respective companies issuing the securities. The risks include changes in consumer tastes and demand, legal suits, competition, changing industry conditions and management omissions and errors.

Credit risk

This relates to debt securities where adverse changes in the economic environment and the financial condition of the issuer may have an impact on its ability to pay interest and principal when they are due.

This reprint implies no endorsement, either tacit or expressed, of any company, product, service or investment opportunity.