FINANCIAL TIMES
MONDAY OCTOBER 30 2006

BOUTIQUES FTfm

New-found freedom from bias and hubris

Focus Capital's **John Cleary** tells **Steve Johnson** liberty to diversify is key with emerging markets

A desire to escape the overweening ego of the typical investment professional has played its part in persuading John Cleary to go it (almost) alone after 20 years in the fund management business.

Until September, Mr Cleary was chief investment officer at Standard Asset Management, running white-labelled high yield and emerging market funds for American Express. Before that he was head of emerging market debt and global high income at Invesco Asset Management, with West Merchant Bank and SG Warburg also popping up on his CV.

But Mr Cleary has stepped out of the comfort zone to launch London-based Focus Capital, a specialist emerging markets boutique, alongside Elena Villalba, an evacuee from the Spanish division of American Express Funds.

The move came after Mr Cleary decided that the only sound way to invest in emerging markets was via a vehicle that can freely switch between bonds, equities, hedge funds and even cash, to exploit different stages of the economic cycle. Furthermore, he felt this could only be done objectively in an independent house.

"There are inherent biases in investment firms. They are generally known either for bonds or equities, there are very few worldwide that have a balance. As managers get promoted to a higher political position, if they understand bonds, say, then that is an easier sell. It takes a lot to get over that barrier."

In addition, many in-house funds of funds are constructed largely of their own funds, whereas Mr Cleary wanted a free hand to look at all managers without a conflict of interest.

But, equally importantly, he did not want to be held hostage by the peccadilloes of individual managers.

"If you have a good fund manager, you have to manage his ego, his bonus and his salary," he says. "Good managers have the tendency to believe they are invincible, that they are masters of the universe, but markets can be very humbling."

The first product, a fund of funds called Focus Capital Emerging World, is due to arrive in the first quarter of next year. It will be free to invest across the emerging market asset space, but Mr Cleary hopes, it will escape these twin terrors of bias and hubris.

"We consider equity, bond and hedge funds should all be part of emerging market investing. Diversification is the best risk management tool for this asset class.

"No one manager can outperform in all market conditions, especially in emerging markets, and when you are dealing with unpredictable markets, strategic allocations are key."

Mr Cleary will not be too proud to throw in the kitchen sink if emerging markets really hit the fan, with an allocation of 100 per cent cash among the options if necessary.

Unsurprisingly he is bullish about the sector at present. The model portfolio, in the process of receiving seed capital, is 100 per cent invested in equities, two-fifths in Latin America and a fifth each in China, India and the eastern Europe/Middle East/Africa region.

This positioning is based both on a view that we are in an equity-friendly stage of the investment cycle, and a more fundamental faith in the emerging market story.

Although history points to a lack of correlation between economic growth and stock market performance in a given country, Mr Cleary has faith that the rapidly changing economic world order will spill over into equities.

"We believe emerging markets are currently undervalued. Emerging markets already account for more than 50 per cent of world output, 47 per cent of the world's oil consumption, 42 per cent of the world's exports, over 80 per cent of world's oil reserves and 85 per cent of the world's population. Yet these markets account for less than 15 per cent of global market capitalisation."

This manifesto lends itself to a top-down investment thesis. Mr Cleary quotes research indicating that 93 per cent of investment returns are generated by the asset allocation decision.

He will decide on asset allocation, with Ms Villalba, the director of investments, concentrating on individual fund selection. "We will have worked with or against most of these managers in the past," adds Mr Cleary.

The Emerging World fund is an absolute return vehicle that will target a Sharpe ratio of between 3 and 4. Focus Capital has back-tested its model portfolio for the past three years and claims that its Sharpe ratio came out at 3.86, against 1.86 for the CSFB/Tremont Emerging Market Hedge Fund index, 1.8 for the Morgan Stanley Emerging Market Free equity index and 1.23 for the JPMorgan EMBI Global Diversified bond index.

In 1998, the fund would have risen 2.2 per cent, aided by its ability to hold cash in times of strife, while the JPMorgan bond index has fallen 8.1 per cent, the Morgan Stanley equity index has lost 27.5 per cent and the CSFB/Tremont hedge fund index has slid 37.7 per cent.

The fund will have a minimum investment of €100,000 or $100,000 and is aimed at professional investors, private banks, distribution platforms and family offices. Charges will be up to 2 per cent annually, with a 25 per cent performance fee.

The fund will be listed on the Dublin stock exchange and domiciled in the Cayman Islands, with monthly subscriptions and quarterly redemptions.