

# PFS SOMERSET EMERGING MARKETS SMALL CAP FUND

Interim short report 31 March 2011  
(unaudited)

## Manager and Advisers

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(Authorised and regulated by the Financial Services Authority)

### Directors of the ACD

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### Lead Managers

Mark Asquith (Lead Manager)  
Edward Robertson (Co Manager)

### Depositary

The Royal Bank of Scotland Plc  
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(Authorised and regulated by the Financial Services Authority)

### Auditors

Shipleys LLP  
Chartered Accountants and Registered Auditors  
10 Orange Street, Haymarket, London WC2H 7DQ

## Investment Objective & Policy

For the half year from 01 October 2010 to 31 March 2011

The Sub-Fund seeks capital appreciation by investing in an actively managed portfolio composed principally of quoted equity securities, issued by companies established or operating in emerging market countries, principally in Asia, Eastern Europe, the Middle East, Africa and Latin America and whose market capitalisation does not exceed US\$2.5 billion at the time of the investment. The Sub-Fund may also invest in other investment funds in order to gain exposure to specific markets or the expertise of specific managers. The Sub-Fund generally seeks to maintain a diversified portfolio in order to reduce its dependence on specific companies or industry sectors.

The Sub-Fund may invest in cash and near cash, and in shares in other collective investment schemes subject to the limits set out in Appendix 2 of the prospectus, however, investment by the Sub-Fund in other Schemes will be limited to a maximum of 10% of the scheme property of the Sub-Fund.

## Managers' Review

### Interim Report for the Somerset Emerging Markets Small Cap Fund OEIC

We were delighted to launch our Global Emerging Markets Small Cap Fund on 2nd November 2010 and thank you to all our clients for supporting our strategy. Turnover since launch has been low as expected but it is worth reviewing the reasons behind the various purchases and sales before turning to our outlook over the coming months.

#### DECEMBER

In December we sold Indian commercial vehicles manufacturer Eicher Motors since the stock had reached 19x p/e. A lot of the 'free' growth had been priced as operating leverage worked its way into higher margins. Asset turnover was 1.6x versus 0.9x for fellow CV manufacturer Otokar. New emissions norms led to a further surge in demand in the first half but were unlikely to be repeated. There was also increasing competition coming into the sector from Mahindra & Mahindra and smaller players. In addition customer financing costs were rising. It remained an attractive company but valuations did not discount the risks.

We bought Malaysian latex glove manufacturer Top Glove. This impressively well run company was facing difficult conditions and therefore reasonable valuations. The rubber price (from which latex is derived) rose 25% in November alone after an already strong 2010. Latex makes up 60% of Top Glove's costs and it's last quarter's results were poor as a result leading to a sell off in the stock and an attractive entry level. With almost 30% of global market share their pricing power was good but they have not been able to pass all costs through as a result of the velocity of the cost increases. This situation should not be permanent and Top Glove should take advantage of its competitive position to further consolidate market share. The opportunities for growth in emerging markets are significant. We were below consensus in our estimates for 2011 but still predict 6% FCF yield, 3% dividend yield and 16x p/e for the stock. Any change in the negative outlook would provide even more attractive numbers.

We also bought E Ink, the innovator of the Kindle's unique reading display which it also sold to other E-readers. We considered buying the stock in 2009 but the earnings stream was unproven, debt was high as were valuations. All of these improved over 2010 and we considered the earnings outlook to be unusually strong.

## Managers' Review

continued

### JANUARY

In January we bought Pruksa. I met them in Bangkok in November and was impressed by their good working capital and balance sheet practices. A focus on low-rise, pre-cast housing and a low land-bank policy translated into only 161 days working capital, lower debt and frequent free cash flow. They are now the largest property developer in Thailand by sales although their market cap is 65% of more famous and asset intensive Land & Houses. At 9x p/e and with at least 40% upside to our fair value we added the stock to the portfolio at the end of the month.

We sold Glaxo Smith Klein Consumer. This has been a very difficult decision as the company is still fantastic with an unchallenged position in malted drinks and a profitably expanding portfolio of food and drink products in India. The latest results were further proof of its strength and its sustainable growth should be somewhere near 18%. At 30x it was the most expensive stock in the portfolio however and we found it difficult to see further upside at these levels. Although they handle it well, rising input costs may be an issue, along with execution risk for new product launches and these risks were not factored into valuations.

We sold Sibir Telecom after the catalyst (merger with other regional telecoms) had been realised.

### FEBRUARY

We sold Saraiva on concerns the margin gain had been diluted by diversification into online retailing which involves selling electronics and other lower margin goods. One of the things we liked about Saraiva was the fact that management were incentivised on 'cash value added' whereby the management were rewarded on the cash they generated over the cost of capital. What seems to have happened however, perhaps coincidentally, is that their cost of capital has been lowered through increased debt funding including lowest cost BNDES funds. At 22x p/e we considered these negatives not fully priced in and sold the stock.

With the proceeds we bought Cremer, the largest healthcare products provider in Brazil, although largest only with 8% market share. Future growth will depend on their ability to consolidate the fragmented marketplace. If done successfully, as with Odontoprev, this can lead to tremendous growth and profitability. The provision of healthcare products to retailers and hospitals is lower end than health insurance however so we see lower barriers to entry. The company should be able to achieve at least the underlying 10-15% growth rates of the industry however as Brazilians spend more on healthcare. ROAs are 11%, the company has a net cash position and it trades at 13.5x.

After much debate we also sold Otokar. This Turkish commercial vehicles and defense manufacturer was a company the analysts were very keen should be in the fund and I was less enthusiastic about. The lumpiness and volatility of orders made the company's cashflow very hard to predict. Profitability in some years could be quite high for its industry but it was always hard to know when. The most compelling reason to own it was its historically low asset turnover and indeed it turned out to have been well timed as profits look likely to double to the end of 2011. If they do this however the stock will still be trading on 15x earnings which, given its industry, is expensive in our eyes. After a tremendous run we decided to take profits.

## Managers' Review

continued

Macronix was bought with the proceeds. Its technology (ROM and Serial Flash memory) is considered 'sunset', which means its life cycle is expected to be shorter but its competition is much lower. 10-12% of revenues goes to R&D so there is the likelihood of new technology being produced. In the meantime Nintendo provides strong demand and is launching a new product this year. Macronix makes 24% net margins, 34% ROA, 50% cash/market cap and a 7% dividend yield. At 7x p/e we thought this was undervalued.

We exited Hyundai Mipo as we only had three months left to sell it as it went over \$2.5bn last year. We continue to like the company and valuations but can no longer hold it given the size. With the proceeds we bought Yuhan corporation. The team saw this pharmaceutical company in Korea last year. It has a joint venture with Kimberly Clark for household and personal care products which has strong export presence in China. It has 11% ROA, net cash and good growth prospects for 13x p/e.

### Attribution

The fund was hurt by a sharp fall in Allied Digital's stock price at in February. The company was investigated by the Income Tax Department at the beginning of February. 14 other companies have had similar raids since November and even Infosys has been subject to a tax dispute. The fact that Indian small caps were being sold across the board and that T Rowe Price (who held 7% of the stock) sold all of their holding aggressively meant the stock fell heavily. We met the company and, after a share buyback was instigated, we sold the stock at higher levels given the low probability of investor sentiment recovering on the stock in the medium term.

Macro trends which hurt the small cap asset class were a pronounced increase in rates of inflation from November onwards. Given the preponderance of consumer facing companies and cost takers in the small cap universe this hurt earnings outlooks and valuations. There are few energy or integrated materials stocks protecting the asset class from this, unlike in the large cap universe.

India, after strong performance, was the worst relative performer from November given its greater exposure to inflation and oil price shocks, corruption and corporate governance scandals over the period and higher valuations.

### Outlook and strategy

After the de-rating of the asset class owing to the above trends, valuations are attractive again. The fund is at 14.8x trailing valuations (universe at 15.7x) and 13x forward earnings. Whilst not trough valuations we think these are attractive given the strong earnings growth many companies display. The main threat remains inflation, especially if there is a sharp spike in oil and commodity prices. The main opportunity is the need for investors to move out of fixed income and into equity given the impossibility of rates going any lower and the probability of inflation eating away returns. Small cap Global Emerging Markets will benefit if real Asian/Emerging incomes rise which we think possible.

**Lead Manager, Mark Asquith**

## Fund Facts

### Accounting and distribution dates

	Accounting	Distribution
Interim	31 March	31 May
Final	30 September	30 November

### Net Asset Values

Share Class	Year	Accumulation Shares		
		Net Asset Value	No. of shares in issue	Net Asset Value per share)
Class B GBP	2011*	2,816,049	3,058,377	92.08
Class B EUR	2011*	13,418,140	16,800,424	90.22
Class B USD	2011*	11,546,320	20,165,487	91.78

\* As at 31 March 2011

### Price History

The table below shows the highest buying and lowest selling prices on a calendar year basis in pence per share/unit for five full calendar years/ since launch.

Past performance is not necessarily a guide to the future performance.

Share Class	Year	Accumulation Shares	
		Highest	Lowest
Class B GBP	2010	102.31	86.79
	2011*	101.40	100.19
Class B EUR	2010	103.20	98.90
	2011*	104.83	86.54
Class B USD	2010	101.84	94.19
	2011*	99.11	87.21

\* As at 31 March 2011

### Distribution Record

Share Class	Year	Accumulation Shares
		Net revenue per share (pence)
Class B GBP	2011*	0.2557
Class B EUR	2011*	0.1654
Class B USD	2011*	0.1872

\* As at 31 March 2011

**Fund Facts (continued)****Total Expense Ratio**

	<b>31 March 2011 %</b>
Class B GBP Manager's charge	1.25
Class B GBP Other expenses	0.35
Total expense ratio	1.60
Class B EUR Manager's charge	1.25
Class B EUR Other expenses	0.35
Total expense ratio	1.60
Class B USD Manager's charge	1.25
Class B USD Other expenses	0.35
Total expense ratio	1.60

The total expenses ratio is annualised based on the fees incurred during the accounting period.

Prices and yields as at 1 April 2011 (first XD dealing date)

	<b>Accumulation Shares</b>	
	<b>Price pence per share</b>	<b>Yield %</b>
Class B GBP	93.30	0.27
Class B EUR	91.83	0.18
Class B USD	93.16	0.20

**Risk Warning**

Please remember that past performance should not be seen as a guide to future performance and that the value of an investment and income from it can fall as well as rise and may be affected by exchange rate variations.

## Fund Facts (continued)

### Sector spread of investments at 31 December 2010

Investment Companies	20.44%
Food Producers & Processors	9.21%
Pharmaceuticals	9.05%
Electronic & Electrical Equipment	7.11%
Real Estate	6.94%
media & Photography	6.77%
Construction & Building Materials	6.73%
General Retailers	4.86%
Engineering & Machinery	4.45%
Banks	2.94%
Information Technology	2.72%
Gas Distributors	2.59%
Beverages	2.48%
Leisure, Entertainment & Hotels	2.28%
Transport	2.24%
Insurance	2.23%
Housing Goods & Textiles	2.22%
Software & Computer Services	0.66%
Net other assets	4.11%

### Major Holdings

The top ten holdings at the period are shown below.

Holding	% of Fund as at 31.12.10
Grupo Herdez SAB-Series	4.16
Valid Solucoes	3.61
Federal Bank	2.94
Heidelbergcement India	2.89
BEC World	2.79
Alliance Global	2.77
Travelsky Technology	2.72
Robinson Department Store	2.66
Security Bank	2.63
Top Glove	2.60

## General information

### Authorised Status

PFS Somerset Capital Management Investment Funds ICVC (the “Company”) is incorporated in England and Wales as an ICVC under registration number IC000713. The Shareholders are not liable for the debts of the Company.

The Company is authorised by the FSA as a UCITS Scheme under the COLL Sourcebook and is an umbrella company for the purposes of the OEIC Regulations with each Fund being a UCITS Scheme. The effective date of the authorisation order made by the FSA was 17 October 2008.

### Buying and selling units

The ACD will accept orders for the purchase and sale of shares on normal business days between 8.30am and 4.30pm. Instructions to buy or sell shares may either be in writing to: PO Box 10282, Chelmsford, Essex CM1 or by telephone on 0845 026 4282.

A contract note will be issued by close of business on the next business day after the dealing date to confirm the transaction.

### Report and accounts

This document is a short report of PFS Somerset Emerging Markets Small Cap Fund for the period ended 31 March 2011. The full Report and Accounts for the Fund is available upon written request to Phoenix Fund Services (UK) Ltd, PO Box 10282, Chelmsford, Essex CM21 9LJ.

### Other information

The information in this report is designed to enable you to make an informed judgement on the activities of the Fund during the period it covers and the results of those activities at the end of the period.

### Risk Profile

The Fund has little exposure to credit or cash flow risk. There are no borrowings or unlisted securities of a material nature and so there is little exposure to liquidity risk. The main risks it faces from its financial instruments are market price foreign currency and interest rate risk. The ACD reviews the policies for managing these risks in order to follow and achieve the Investment Objectives as summarised on page 2.



Phoenix Fund Services (UK) Ltd.

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