

SOMERSET CAPITAL MANAGEMENT LLP

Somerset Emerging Markets Small Cap Fund OEIC

31 December 2011

Investment Adviser's Monthly Report

Assets Under Management

Somerset Capital Management LLP:	\$1,156 million
Somerset EM Small Cap Fund OEIC:	\$70.6 million

GBP Performance

	<u>Fund</u>	<u>MSCI EM*</u>
Dec 11	1.51%	0.09%
YTD	-17.92%	-17.99%
Since Inc**	-16.84%	-13.19%
Price***	83.16	

EUR Performance

	<u>Fund</u>	<u>MSCI EM*</u>
Dec 11	3.46%	2.51%
YTD	-15.62%	-15.87%
Since Inc**	-14.00%	-9.96%
Price***	86.00	

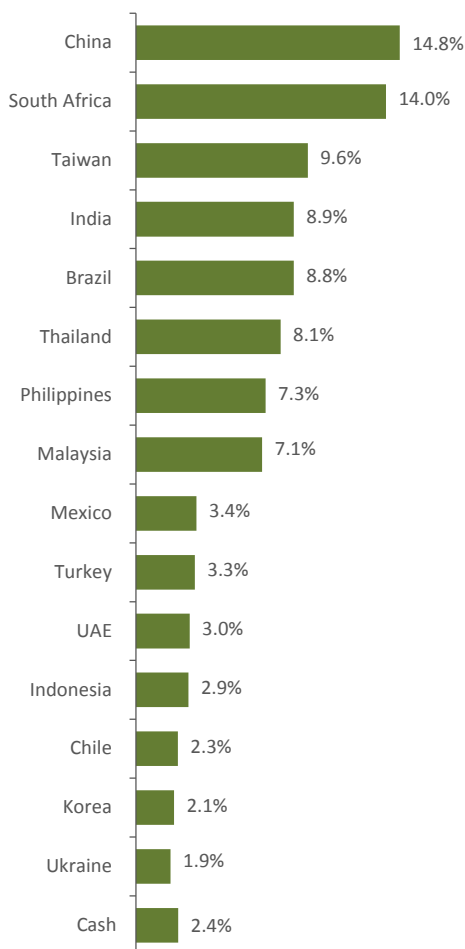
USD Performance

	<u>Fund</u>	<u>MSCI EM*</u>	<u>MSCI SC EM</u>
Dec 11	0.52%	-1.21%	-1.31%
YTD	-18.72%	-18.42%	-27.18%
Since Inc**	-20.36%	-16.06%	-25.23%
Price***	79.64		

Portfolio Data

	<u>Fund</u>	<u>MSCI EM</u>	<u>MSCI SC EM</u>
Estimated Div Yield	3.3%	3.0%	3.2%
P/E (Historical)	13.0	10.7	14.8
Wgt Ave Mkt Cap (\$m)	1,149	17,560	416
Number of Stocks	36		

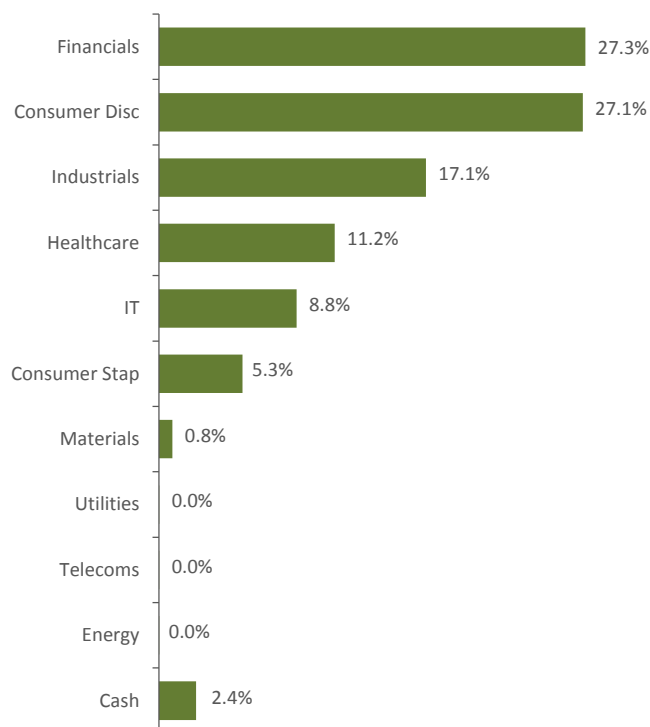
Fund Country Weightings



Top Ten Stocks

	<u>Country</u>	<u>% MV</u>
BEC World (F)	Thailand	4.5%
Security Bank Corp	Philippines	4.4%
JSE Limited	South Africa	4.0%
Top Glove Corp	Malaysia	3.8%
Valid Solicoes SA	Brazil	3.7%
Sino Biopharmaceutical	China	3.6%
E Ink Holdings	Taiwan	3.5%
The Foschini Group Ltd	South Africa	3.5%
Giant Manufacturing	Taiwan	3.5%
Grupo Herdez SAB-NOM SHRS	Mexico	3.4%

Sector Breakdown



* Source: Bloomberg. **The fund launched on midday of 1st November 2010 and for comparative purposes the MSCI performance shown is based on the MSCI level of 1st November. *** For Accumulation Share Class.

The Index is the MSCI Emerging Markets Index with net dividends reinvested taken from close on 1st November. Note the Fund began investing on 2nd November 2010. Other important information: The value of an investment and any income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Investment in emerging markets can involve greater risk than is customarily associated with more mature markets which means greater price movements, both positive and negative, can be expected. Please read the Prospectus before making an investment. This document is issued by Phoenix Fund Services (UK) Ltd which is authorised and regulated by the Financial Services Authority (www.fsa.gov.uk), 25 The North Colonnade Canary Wharf, London E14 5HS. The registered office of Phoenix Fund Services (UK) Ltd is Springfield Lodge, Colchester Road, Chelmsford, Essex CM2 5PW. This document was issued at the date displayed below. Phoenix Fund Services (UK) Ltd is unable to offer personal financial advice and please note that nothing contained in this document should be interpreted as financial advice. If you have any doubt as to whether this product is suitable for you or have questions concerning your tax position, and you wish to obtain personal advice then please contact a financial advisor or where applicable a tax specialist.

Christmas this year involved three main activities: changing my son's nappy at three in the morning, binge-reading books on value investing and lapping up the odd political thriller. The first activity was not particularly thought provoking other than making me realise I was much keener than normal to get back to work this month. The second two were more entertaining.

Ploughing through Joel Greenblat, Howard Marks and Pat Dorsey there is the pleasing double hit of 'Yes, that's just what I think' and 'If I only implement that my process will be perfect'. Underneath lurks the knowledge that the real enemy is our own psychology.

The Fear Index, Robert Harris' latest thriller, has great fun with an algorithmic trading machine that is parasitic on human fear and greed, profiting when markets crash and, in a twist of reflexivity, creating the crashes itself. Perhaps our greatest fear is the growing superiority of our tools. The one thing missing from Harris' book is any mention of intrinsic value. The machine plays with and influences the flow of money as if it were purely arbitrary. This is the logic of a post-modern trader for whom movement is everything, value nothing. Yet however hard it is to judge, every asset has a price at which it is fairly valued and it ultimately tends to gravitate towards this. A machine is unlikely to judge this value any better than a human. In this light James Moniter's emphasis on the empathy gap (the inability to act as one should in the heat of the moment) and the importance of pre-commitment to set buying and selling targets is the real challenge. But if we actually succeed in acting dispassionately, how can we be sure our targets are correct? What is intrinsic value?

Crispin Odey has a wonderful phrase: 'equity is amphibious'. This strikes me as more and more apposite. When it is cheap it is an asset (trading below book, yielding high and steady dividends), when it is expensive it is a concept (At 100x earnings, the promise not just of riches but of wonderful new internet or housing utopias). It crawls out of the swamp, muddy and hideous, chances upon a passing princess, comes into possession of a decent-sized palace but ends up back down amongst the reeds. When studying pond-life it is quite hard to tell an attractive frog from an ugly one, but it is relatively easy to spot a tadpole or a prince.

Equally, intrinsic value is one of the three states of equity. The first is the price at greed (the prince), a price unjustifiable under even the most optimistic assumptions. The second is intrinsic value (the frog). Whilst accepting a discount of all future cash-flows as the most correct way to value a stock, we also accept our own inability to predict this perfectly. The danger is in having just one price. We can predict cash-flows based on the company's past and expected volatility, sustainability and quantity of cash generated but we can never be sure these will come true. More than that, at the current moment an infinite variety of prices could be 'correct' as there are infinite possible futures. Quantum physics draws clouds of probability around the nucleus of an atom to suggest where an electron is most likely to be as it is impossible to locate precisely, no matter how advanced the computer (see Heisenberg). In just such a way do we need a 'cloud' of probability in our pricing of a stock. At the upper end of the range is our base level calculation of intrinsic value, at the lower range is our margin of safety or entry level calculation. These are our handsome and ugly frogs. The third state of equity is the price at fear (tadpoles), a price unjustifiable under even the most pessimistic assumptions. Ideally we want to be buying tadpoles but we will consider ugly frogs.

By trying to give as many stocks in our universe (and funds) an entry level and a target we can begin to implement James Moniter's policy of pre-commitment when markets tumble or inflate. This is our project for 2012.

Mark Asquith, Lead Fund Manager

Fees	
	1.25% AMC
	0% Initial Charge
	5% Absolute Performance Fee

Share Class Information		
	<u>Accumulation</u>	<u>Income</u>
EUR SEDOLs	B5W4Q51	B4N4VD6
EUR ISINs	GB00B5W4Q517	GB00B4N4VD61
GBP SEDOLs	B3M2G51	B4QW687
GBP ISINs	GB00B3M2G516	GB00B4QW6872
USD SEDOLs	B3PZH10	B5TJNL4
USD ISINs	GB00B3PZH106	GB00B5TJNL41

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