Peer Insights REPORT

Q&A with Ethan Spencer

Founder and Portfolio Manager of Eastern Point Capital Management

Principle Series:

Family Office Insights sits down with Ethan Spencer, Founder and Portfolio Manager of Eastern Point Capital Management, to talk about emerging and frontier markets and the importance of investing on a global scale in a local capacity.

Q: What is your fund's strategy? Why do you believe in 'local' over global emerging market investing?

A: The Eastern Point Emerging Markets Fund invests in emerging and frontier equity markets globally by allocating capital to long-only investment managers typically based on the ground in the country or region where they invest. Our managers are experts in their specific geography, manage relatively small pools of capital, and conduct deep fundamental research. The result is a collection of concentrated portfolios in off-the-run securities that are generally uninvestable for the larger global funds, most of which are based in developed markets and invest predominately in the large index constituents. Our underlying companies are not generally part of any MSCI index or an investable ETF. We view this differentiation as a competitive advantage because the largest companies in these markets are often efficiently priced and export oriented, therefore they are not as linked to true domestic emerging market growth. We believe our 'local' portfolio provides clients with better access to the emerging markets growth story, like domestic consumption and middle-class growth focus. This is the same strategy that the large endowments and foundations have successfully used for the past decade. We provide this strategy to smaller institutions that do not have the resources and bandwidth to create it on their own.

Q: How do you view emerging markets overall today?

A: From a macro perspective, emerging markets are not exceedingly cheap on an absolute basis. However, emerging and frontier markets generally have better growth prospects and more attractive valuations than developed markets. As of June 30, 2015, the MSCI Emerging Markets Index returned 4% annualized over the prior five years while the MSCI World and S&P 500 returned 14% and 17%, respectively. As a result, the relative valuations of these indices have diverged materially. The price to earnings ratio of the MSCI EM Index was 13.9 versus 18.2 and 18.4 for the S&P 500 and MSCI World respectively, and the price to book ratio of the EM Index was 1.6 versus 2.8 and 2.2 for the other two indices. Similarly, the dividend yield of the MSCI EM Index was 2.8% versus 2.1% and 2.5% for the S&P and MSCI World indices. So while we believe EM valuations provide a decent starting point today, owning the EM Index does not excite us. Through our local managers we own a completely different, and more attractive, set of businesses. Our portfolio offers significantly better value than the index, which we believe will translate to attractive long-term returns to our investors.

Q: Why are both emerging and frontier markets an appealing space for the high-net-worth investor?

A: Over the long-term, emerging and frontier market equities should provide investors with good returns and diversification. In the nearly 15 years since the inception of the current MSCI Emerging Markets Index (December 29, 2000 – July 31, 2015), the Index has a cumulative return of 284.7% or 9.7% annualized. The MSCI World and S&P 500 have returned less than half of that over the same period, with the MSCI World Index returning 90.9% cumulative and 4.5% annualized and the S&P returning 94.4% cumulative and 4.7% annualized.

From a diversification standpoint, The MSCI World and S&P 500 have a correlation of .97 over that time period. The MSCI Emerging Markets Index has a correlation of .86 with the MSCI World Index and .78 with the S&P 500 over the same time period.

Importantly, we believe both the return and correlation numbers of the MSCI EM Index understate the attractiveness of our specific portfolio, which has almost no overlap with the MSCI EM index. The quality of our off-the-run portfolio should provide even better returns with less correlation.

Q: How does the firm perform due diligence on the managers you invest in?

A: Our diligence process is exhaustive. We meet with primary decision makers as much as possible. We meet most, if not all, of an investment team multiple times before investing. We look for a pattern of success with managers that is analyzable and repeatable. Because our managers are located throughout the emerging markets, significant travel is a necessary component. We travel multiple times per year to Asia, Africa, Eastern Europe, and Latin America to source and research new ideas as well as monitor current investments.

While specific approaches to research, portfolio construction, and risk management will differ across our managers, there are certain qualities that all share. The following are key investment criteria: fundamental, value-based investment strategy; teams with high integrity; well-established organizational structures; disdain for leverage; original and thorough research; significant financial commitment to their fund and firm; and a willingness to maintain an open dialogue.

We also undertake rigorous quantitative analysis on each manager before investing. If we have done our qualitative work well, we expect quantitative work to support our thesis. Quantitative efforts focus on analyzing historical performance, exposures, and attribution. If the quantitative work leads to a different conclusion, we go back to the drawing board or shelve the investment entirely if the two cannot be reconciled. Importantly, we do not approach it from the opposite direction such as starting with the quantitative work, as we do not want to be biased by historical returns that may not be predictive of future results.

Q: What is your competitive advantage?

A: First, we have an experienced team with a combined 23 years of researching and building multi-manager portfolios. In addition, we have experience building out a $1 billion plus university endowment investment office, investing over $700 million of endowment fund assets, overseeing manager research at a global consulting firm and managing over $200 million in private client assets. Our experience has resulted in a deep network throughout emerging and frontier markets with managers, endowments, foundations, family offices, consultants, bankers and service providers, among others.

Second, we are highly focused. We manage one strategy. All of our efforts are focused on sourcing a select handful of talented fund managers. We do not try to be all things to all people. Our focus allows us to go deeper into the asset class than others.

Third, we have structured the organization to maximize our alignment of interest with investors. Some examples are the performance fee class only charges fees on excess returns with no management fee, all fees decline as AUM increases above a threshold, and we eat our own cooking.

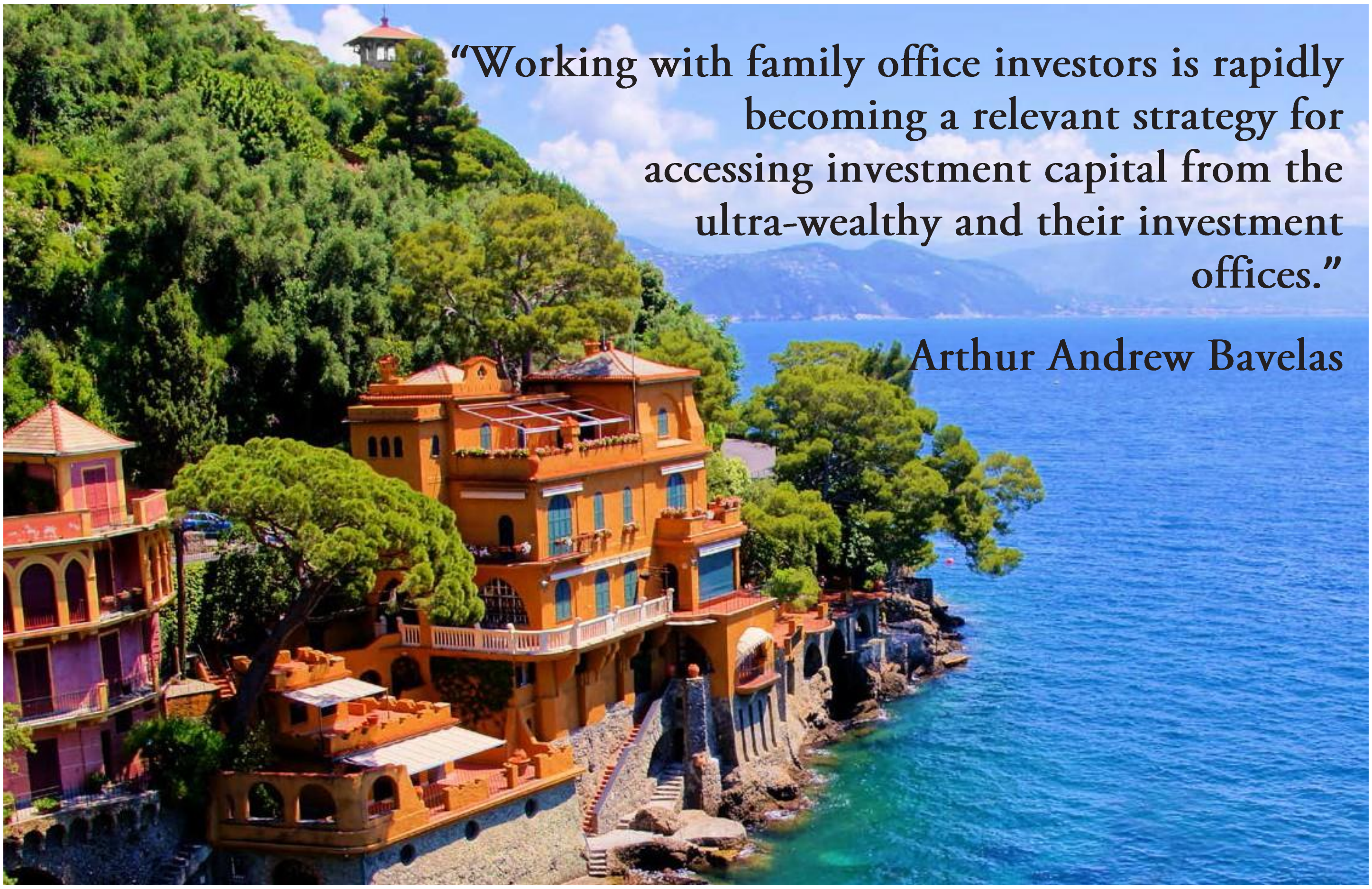
Lastly, we have a long-term commitment from Schooner Capital, a single-family office with a long history of investing in emerging markets. Schooner provided a multi-year commitment of working capital and anchor investment in the fund. This commitment enabled us to build an institutional quality firm from day one and focus our time and resources on managing the portfolio.

Q: Who is your ideal investor?

A: Our ideal investor is an entity (endowment, foundation, family office, etc.) that wants a truly differentiated emerging market equity exposure and has a long-term outlook and is comfortable with volatility. Our process results in a portfolio of off-the-run EM companies, and our performance will deviate materially from the EM Index at times due to the skew towards small-cap domestic consumption oriented businesses, rather than the multi-national export driven companies (and SOEs) that dominate the indices. We are comfortable with short-term underperformance to generate outstanding long-term returns, and our investors need the same mentality. In addition, the ideal investor understands the shortcomings of the various passive EM investment vehicles (and large active global vehicles) and specifically wants exposure in these markets that is more closely linked to the underlying growth of the economies.

Ethan Spencer

Ethan Spencer is the founder and Portfolio Manager of Eastern Point Capital Management. He has worked in the investment business focusing on manager due diligence and multi-manager portfolios since 2001. From 2008 – 2013, Spencer was a Director in the Investment Office at Boston University, primarily overseeing public equity and hedge fund investments. Previously he worked at Cambridge Associates as a Senior Research Consultant in the Hedge Fund Research Group from 2005 through 2008. For more information, please visit http://www.easternpointcap.com/ or email Spencer at ESpencer@easternpointcap.com .


"Working with family office investors is rapidly becoming a relevant strategy for accessing investment capital from the ultra-wealthy and their investment offices."
Arthur Andrew Bavelas