CAMRADATA
A With Intelligence Company

Emerging Market Equity Whitepaper

Sponsored by

ARTEMIS
The Profit Hunter

MACKENZIE
Investments

Premier Miton
INVESTORS

Clear and Independent Institutional Investment Analysis

We provide institutional investors, including pension funds, insurance companies and consultants, with data and analysis to assess, research and report on their investments. We are committed to fostering and nurturing strong, productive relationships across the institutional investment sector and are continually innovating new solutions to meet the industry's
complex needs.

We enable institutional investors, including pension funds, insurance companies and consultants, to conduct rigorous, evidence-based assessments of more than 5,000 investment products offered by over 700 asset managers.

Additionally, our software solutions enable insurance companies to produce consistent accounting, regulatory and audit-ready reports.

To discuss your requirements

+44 (0)20 7832 6517
info@camradata.com
LinkedIn
@camradata

camradata.com

Contents

Welcome to CAMRADATA's Emerging Market Equity Roundtable

As a very broad church, global emerging markets offer investors one of the most expansive opportunity sets for their investment portfolio.

As an asset class, it covers the widest range of sectors, industries and geographies, along with growth drivers that developed markets can only see in the rear-view mirror.

Despite all this promise, EM equities have often failed to deliver, leading to disappointment and shrinking allocations.

Additionally, these markets often act as a bellwether for wider economic disquiet, with allocations being some of the first to be liquidated within a flight to safety at the first sign of trouble. This can compound losses, leading to a vicious cycle of outflows.

Yet, after a lacklustre year in 2022, global emerging market equities piqued investor interest again as 2023 dawned.

According to Reuters, in the first half of this year, analysts expected cheaper valuations, a weakening dollar, peaking Fed rates pricing and lower US Treasury yields to bolster EM assets.

Additionally, data from Refinitiv showed emerging market firms are expected to post 11.9% profit growth in 2023, much higher than that of US firms (8.9%) and European firms (-2.2%).

For investors this poses a conundrum. With high valuations in developed markets and a poor economic outlook, should they step back into this asset class that has let them down before, or has the mood music changed?

And does the spectre of a potential Chinese invasion of Taiwan hang heavier on these markets than any other?

In this whitepaper, we will discuss the attraction of EM equities and the challenges investors face when allocating to this asset class, from risk through transparency and sustainability.

Meet the Team

Sean Thompson
Managing Director

Natasha Silva
Managing Director, Client Relations

Amy Richardson
Managing Director, Business Development

Sam Buttress
Associate, Business Development

Sarah Northwood
Marketing and Events Coordinator

Orin Ferguson
Associate, Business Development

Emerging Market Equity Roundtable

The CAMRADATA Emerging Market Equity Roundtable took place in London in June 2023

Why 2023 could be a turning point for emerging markets

Emerging markets have had a habit of testing equity investors' nerves, but a series of global shifts could be culminating to create a compelling entry point.

The asset class is commonly seen, particularly by developed market investors, as more risky, meaning that global asset allocators usually cut emerging markets first in their rush to safety.

Proponents might argue that there's a self-fulfilling prophecy that makes emerging market equities volatile; international investors view them as volatile, which causes them to quickly reduce exposure for almost any reason, which creates rapid flows of capital, thus causing volatility.

This flight of capital is a fundamental challenge faced by emerging markets, but other hurdles include global investors' risk budgets, their ability to genuinely adopt a long-term investment horizon, and the perception of the emerging market cohort's ability to meet the West's desire for ESG-compliant investments.

CAMRADATA invited a panel of industry leaders to discuss the challenges faced by emerging markets, and highlight the opportunities available for patient, long-term investors willing to thoroughly research the potential winners.

Allocation conundrum

Emerging markets are probably one of the broadest subset of stocks available to investors, covering the widest range of sectors, industries and geographies. But this diversification hasn't led to the broadest of emerging market indices producing attractive relative returns compared to global benchmarks.

Data from MSCI shows its Emerging Markets index lagging in virtually every time period in the past decade compared to the global All Countries World index.

"The theme of the past 10 years is that we're still waiting for EMs to have their day in the sun," said Ian Gamon, lead research partner on global equity at LCP.

"The pension trustees and schemes I advise probably have a bit more than 10% exposure through direct equity managers or indirectly via the MSCI All Countries World index, but UK pension schemes are derisking, so demand for equities is declining, which means EM equities have become an even lower priority."

> ***"The risk aversion towards emerging markets has been driven by a very disappointing decade, but what should now be at the forefront of investors' minds is that emerging market equities have outperformed by about 1.2% per annum when looking over a 40-year time horizon"***

Most panellists agreed that their clients probably had around a 10% allocation to emerging markets, with the exception being a 44% allocation in Schroders' most aggressive risk profile 10 portfolio.

Their most aggressive risk profile specifically trades-off emerging and developed markets to attempt to capture a larger EM risk premium. Looking beyond this, Schroder's also has a smaller and appropriate EM weight in other risk profiles, such as 4% in the mid-range risk profile.

But Fiona Manning, manager of the Premier Miton Emerging Markets Sustainable fund, highlighted that the moribund performance by emerging markets since the so-called taper tantrum in 2013, when markets roiled against plans by the US Federal Reserve to begin withdrawing its quantitative easing, had impacted sentiment.

"That led to a big withdrawal of capital from emerging markets and then a relative period of stagnation," she said.

"The dollar strengthened, and US markets crowded their emerging market peers out, while geopolitical tension rose and risk appetite for emerging markets took a significant impact."

Manning noted that capital expenditure had been declining in both emerging and developed markets since the taper tantrum, but she thought there was an " opportunity for that cycle to turn", particularly in relation to emerging nations.

"This is because deglobalisation of supply chains, while negative for productivity globally, is viewed agnostically by emerging markets as they could be beneficiaries of the spending required as part of this move to more regionalised production, and expectations for GDP in emerging markets are well ahead of their developed peers, with the benign US dollar being another positive," she added.

This view was echoed by Raheel Altaf, portfolio manager in the global emerging markets equity team at Artemis.

"The risk aversion towards emerging markets has been driven by a very disappointing decade, but what should now be at the forefront of investors' minds is that emerging market equities have outperformed by about 1.2% per annum when looking over a 40-year time horizon," he said.

"That long-term compounding creates a huge wealth generation effect, and investors should be looking at emerging markets now, as they are a depressed asset trading on cheap valuations with the potential to deliver quite substantial returns."

Mackenzie's head of team, Arup Datta, explained that the heightened investor uncertainty created by geopolitical tensions between the US and China had led to a reduction of emerging market allocation.

However, China plays a significant role in large-cap emerging markets and Datta went so far as to call China a "value buy that's waiting for a catalyst" given its current 10x forward earnings price tag.

"Hopefully that wakes up enough investors to start either allocating more money towards emerging markets or at least holding their ground," he said.

But will investors be enticed by the compelling valuations on offer, or might other concerns outweigh them?

> *"We have clients that use passive strategies for their developed market investing, but for emerging markets, which are less efficient and can have less sell-side analyst coverage, there are plenty of opportunities for active managers to generate alpha."*

Stamina required

An issue for fiduciaries, such as pension trustees and wealth managers, is that even if their scheme members or clients say they have long-term investment time horizons, they still have an annual review whereby any exposure to the likes of emerging markets has to be discussed.

Marcus Stuart-Smith, an Asia and emerging markets fund analyst at RBC Brewin Dolphin explained that investment managers have to meet with clients on an annual basis, and that more recently, emerging markets have been difficult to navigate.

He went on to highlight that this can pose a challenge for investment managers, particularly if they look to allocate on a regional basis within EM. The risk of negative feedback from clients as a result of underperformance can outweigh the potential for positive contribution to portfolio performance, particularly when the position sizes are small.

Brian Leitao, senior research analyst at Mercer, agreed that firms such as his "have to be accountable", and that "volatile returns can be difficult to explain".

"You have to be particularly cautious with small- or mid-cap strategies. When things get rocky, liquidity can dry up quickly and drawdown can be steep," he said.

One common approach for accessing emerging markets that can be perceived to be less risky is indirectly via UK-, European- or US-listed stocks.

The panel acknowledged such a strategy was prominent, with examples including consumer goods firm Unilever and luxury conglomerate LVMH named as popular EM-proxies.

But Weichen Ding, director within the public markets team at bfinance, felt one of the main benefits of more direct emerging market investments was the broad, differentiated opportunity set.

"Diversification is the main reason for considering EM," he said. "Greater levels of risk management might be required, but there's definitely alpha to be had.

"We have clients that use passive strategies for their developed market investing, but for emerging markets, which are less efficient and can have less sell-side analyst coverage, there are plenty of opportunities for active managers to generate alpha."

Mackenzie's Datta agreed that there is more alpha to be had in emerging market strategies, but fund managers must adopt capacity constraints to maximize the potential for capturing it. The breadth of emerging markets in terms of number of stocks plays into the quant strength.

"You can't load up your assets in emerging markets because the capacity is a lot less in emerging markets than in US large cap, so the right EM manager should also have capacity constraints so they can continue to deliver the alpha," he said.

Furthermore, the panel was unanimous on the particularly enticing valuations on offer within emerging markets at present, stating that it could be beneficial for investors to consider reviewing their exposure sooner rather than later.

"When the majority of investors are suggesting that something is too risky or uninvestable, and that its price is at the end of the Earth and never coming back, that might be attractive if too much bad news is in the price, but you do need available capital and a good risk-management framework to selectively take advantage of the opportunity," said Robert Starkey, co-manager of the Investment Solutions range at Schroders.

Artemis's Altaf added that since the last time emerging markets were more popular with global investors, developing nations had many more successful, domestic companies to invest in.

"There has been quite a significant amount of equity issuance in the past decade, and there are lots more companies in emerging markets with prominent brands that resonate highly with domestic consumers," he said.

"Most industries have companies that can compete with western counterparts, and often consumers prefer the home-based businesses; if you want to benefit from that growth, you have got to be invested in domestic emerging market firms."

Nevertheless, a persistent perception of emerging markets as risky by international investors, coupled with rising geopolitical tensions, could be a hurdle to increased allocations.

Navigating narratives

One of the biggest perceived risks that the panel stated investors often quoted, was China.

From fears about its ambitions for Taiwan through to concerns about the trustworthiness of data emerging from it, many investors appear cautious when it comes to the world's second-largest economy.

"China is a big risk factor, and its relations with Taiwan are always going to be there, as could the mutual stance with the US," said bfinance's Ding.

"Corporate governance is another one, but that's why I always suggest our clients use an active manager, because if you use a passive strategy, you have to invest in companies with poor corporate governance," he added.

Artemis's Altaf added he had "lost count" of the number of clients who had asked him how any data from China could be trusted.

"But what they maybe don't understand straight away is that there are at least 2,000 companies to invest in, so if you are negative on China, there are still companies that you can buy that are based there and will perform exceptionally well," he said.

"If you're data driven, you can be quite agnostic about where the winning companies come from," he added.

Mercer's Leitao added that he's seen the increased hiring of Mandarin speaking analysts by emerging market managers over the last few years.

"Language is clearly one reason, but beyond that, they bring a strong intuition of government policy, where it's trying to go and what the cultural driving force behind it is, which can be extremely useful," he said.

A broader issue of sustainability was also discussed by the panel, with delegates citing reservations from their clients and investors about whether investing in developing markets was incompatible with sustainable investing.

LCP's Gamon stated there was often a view that there was a "lack of good analysis available on ESG factors in emerging markets", and that if international investors were particularly concerned about carbon emissions, EM exposure could be tricky given many developing nations' exposure to energy or materials, or the dominance of high carbon-emitting industries.

"That's why it's doubly important to choose an active manager who has detailed information about what companies are doing on the ground," he said.

RBC Brewin Dolphin's Stuart-Smith said challenges exist when convincing investors of the ESG credentials available in emerging markets, which makes in-depth research vital when talking to clients.

He explained that quantitative analysis is an important tool to prevent misinformation from influencing investors' decisions and allow managers and advisers to act in the best interest of their clients and meet their needs.

Mercer's Leitao added that the sustainability dynamics of emerging market economies had also changed substantially in the past 10-15 years.

"They're not exclusively commodity producers and exporters anymore," he said, "they are now also mid-chain manufacturers and consumers, and if you take something like electric vehicles, they are just as much at the start of the value chain [in terms of raw materials] as they are the end consumer, so there's a huge sustainability potential in EMs."

Furthermore, bfinance's Ding stated that just because a firm doesn't disclose its sustainability efforts, it does not automatically mean it is not making progress.

"Those companies that are not disclosing might not be 'bad'," he said. "If an active manager can understand what a company is actually doing, then they can help that firm to understand what they need to disclose and help them improve their practise in this regard.

"If managers can find good companies that are improving their ESG credentials, that's an alpha opportunity for investors," he added.

Schroders' Starkey suggested that it was important for fiduciaries and fund managers to explain sustainability opportunities in the context of emerging markets when clients suggest ESG constraints make it difficult to invest in EM.

"When clients push back on this, I think we have to identify where the biggest change is going to come from, and get some data to back up that narrative," he said.

"It is complicated and delicate plus perspective matters. What's 'ethical' or 'sustainable' is potentially in the eye of the beholder to a person living in each country; if a coal-fired power plant is going to provide jobs, tax revenue and electricity for a struggling economy that doesn't have cumulative emissions, what's right or wrong?"

"This is where social vs environmental priorities for the individual citizen could compete with other objectives, and our award winning proprietary tool – SustainEx – factors these externalities in. It is, however, our job as stewards of capital to urgently move on the path to net zero through funding and engagement, and not prolong change more than necessary where clients have competing ESG priorities"

The development of what investments are available in EM has also been accompanied by a shift in who invests in those markets.

Premier Miton's Manning said the composition of the domestic investor base within individual nations was also important, and that it had evolved in places like India.

"India was very retail investor-focused, and idiosyncratic shifts were based on news flow from flysheets containing stock news," she said.

"That market has massively institutionalised now and become more professional, with a more traditional developed market style of trading activity than 15 years ago."

Mackenzie's Datta agreed that the standard and quality of investing within several EM nations had improved, and made capital flows slightly less erratic.

"This is definitely the case in China, where there is better access now (to the domestic A share market) and it's more professionalised," he said.

"Quant models did not work as well in the pre-connected world of China A markets; we predicted it would once institutional investors flocked there due to the ease of trading via Connect; that has played out as we had predicted with quant models doing well in China A since."

Grasping the future, now

Looking ahead, the panel displayed optimism for the emerging markets asset class, but stressed that investors would continue to need patience, as well as greater levels of diligence to find out the real story on the ground.

"Even though there are issues like the US reducing its imports from China, in the short-term the latter has been passing exports through other economies like Vietnam, but "near shoring" may create opportunities for other economies longer term," said Schroders' Starkey.

He added that the "demographic dividend" generally associated with EMs may also need to be reassessed for a number of economies - such as China – but that the continued rise in the middle class / GDP per capita can potentially provide further tailwinds.

LCP's Gamon added that waxing and waning enthusiasm for EMs provided useful alpha opportunities for active managers, stating that a "long-term perspective is required".

"There will be binary black swans, like Ukraine, and regulatory crackdowns in China," he said. "They will keep coming, but should mean active managers have a great opportunity to add value; they just need to prove they can do this, though, as it's a rare thing."

Those opportunities are highly likely to be found in relation to sustainability opportunities, Premier Miton's Manning claimed.

"I think that there will be a resumption of the capex cycle in emerging markets, and I think a key theme will be sustainability, such as investment in energy transition, innovation and new technology to solve climate-related problems and drive greater productivity," she said.

Mackenzie's Datta restated his views on valuations, which he regarded as "cheap" and added that the opportunity set in emerging markets was vaster than its biggest component – China.

"China is a contrarian call, but India, Korea, Taiwan are a cleaner story, and while India will be expensive, it has never been as easy to invest in for professional investors in both private and public markets," he said.

"I'm not a Modi fan, but the nation has come a long way in terms of being more investor-friendly."

Artemis's Altaf concluded that the main driver of his positive outlook was also valuation.

"The price investors are paying today is low and depressed, and starting valuations have the biggest impact in terms of where you end up," he said.

"Essentially, this is an opportunity to buy into a story that has compelling demographics, with many working-age populations, who are growing increasingly wealthy, and living in economies that are more self-sufficient and resilient after a difficult decade that has tested corporate management teams but seen them emerge stronger," he concluded.

Roundtable Participants

Raheel Altaf

Portfolio Manager, Global emerging markets equity

Personal Profile

Raheel joined Artemis in 2014. He has co-managed Artemis' global emerging markets equity and global equity strategies with Peter Saacke since launch in April 2015 and since April 2022, respectively.

A Cambridge graduate in electrical engineering, he joined Fidelity International in 2002 as a quantitative analyst. In 2007 he was promoted to portfolio manager for a range of funds which grew to $2.5 billion. He moved to Fulcrum Asset Management in 2011.

Company Profile

Artemis is a leading UK-based fund manager, offering a range of active equity and fixed income strategies which invest in the UK, Europe, the US and globally.

Established in 1997, our expertise lies in security selection and conviction investing, implemented by experienced, focused investment teams with significant expertise in their chosen disciplines.

Arup Datta

Senior Vice President, Head of Team

Personal Profile

Arup heads the Mackenzie Global Quantitative Equity Team which provides quantitative investment capabilities in Global and Emerging Markets equities.

Arup has over 25 years of experience in quantitative equity investing. Between 1992 and 2012 he was a Quantitative Analyst, Portfolio Manager, Director of US and Director of Portfolio Management with Man Numeric, where he managed capacity-constrained equity strategies (traditional long only, active extension and hedge funds) in all capitalization strata and regions of the world. In 2012, Arup founded Agriya Investors, a firm focused on global equities, which eventually became the global/ international arm of AJO. As Chief Investment Officer - International, Arup launched capacity-constrained equity strategies in emerging and developed markets.

Arup joined Mackenzie in September 2017 to head the Global Quantitative Equity Team.

Arup has a Bachelor of Technology degree from the Indian Institute of Technology in Kanpur, India, and earned an MBA with distinction from the Johnson School of Management at Cornell University. He is a CFA charterholder.

Company Profile

Mackenzie Investments, founded in 1967, is a leading Canadian global asset manager, headquartered in Toronto with international investment teams in Boston, Dublin and Hong Kong. As part of IGM Financial Inc., a subsidiary of Power Corporation with a history dating back to 1925, Mackenzie benefits from the financial stability of a deep corporate structure while maintaining a boutique investment management profile.

Our distinct and experienced investment teams offer both fundamental and quantitative approaches with expertise across traditional and non-traditional asset classes, including equities, alternatives, currency and multi-asset strategies.

We provide investment management services to pension plans, consultants, foundations and other institutions, building trusting relationships that seek to understand client perspectives. We are committed to delivering strong investment performance and offering innovative, relevant solutions to our clients by drawing on the experience gained through over 50 years in the investment management business.

MACKENZIE
Investments

Roundtable Participants

Fiona Manning

Fund Manager, Premier Miton Emerging Markets Sustainable Fund

Personal Profile

Fiona Manning joined Premier Miton in August 2022 following 17 years at Aberdeen Standard Investments where she was Senior Investment Director and lead manager of the firm's emerging market equity sustainable strategies, including the Emerging Markets Sustainable Equity Fund and the Emerging Markets Sustainable Development Equity Fund.

Fiona also co-managed the firm's emerging market equity strategies and, until 2016, the firm's Latin American Equity strategies. Fiona started her career at Deutsche Asset Management in 2001. Fiona is a CFA Charterholder.

Company Profile

Premier Miton Investors is an active investment manager, with capabilities across equities, fixed income, multi-asset and absolute return strategies.

Our culture provides a platform for our investment teams to flourish and perform. We are independent thinkers, unconstrained by a house view. We take our role as stewards of assets very seriously, and focus on responsibly allocating capital, engaging with companies and considering our impact. We are active members of responsible investing initiatives including Climate Action 100+, the Investor Forum and the Carbon Disclosure Project (CDP). Additionally, we are signatories to the Financial Reporting Council's UK Stewardship Code and the UN's Principals of Responsible Investing.

Our institutional strategies encompass:

1. Sustainable Equities (Global, UK & Europe)
2. Financials Capital Securities (Cocos)
3. Small Cap (Global, US & UK)
4. European Opportunities
5. US Opportunities
6. Corporate Bonds
7. Strategic Bonds

Premier Miton INVESTORS

Weichen Ding
Director, Public Markets

Personal Profile

Weichen Ding is a Director within the Public Markets team at bfinance, where he specialises in equity manager research. He primarily covers Emerging Markets, China and Quantitative equity strategies.

Prior to joining bfinance in 2019, he spent five years as a manager research analyst at Alvarium Investments, a UK-based investment boutique. Weichen is originally from Shanghai, China and speaks fluent Chinese Mandarin. He holds an MSc in Economics from University College London and a BSc in Information Security from Fudan University, China. Weichen is a CFA charterholder.

Marcus Stuart-Smith
Fund Analyst

Personal Profile

Marcus covers Asia and Emerging Markets within the Fund Research team at RBC Brewin Dolphin.

Previously he worked on private client portfolios at Punter Southall Wealth. Marcus has a degree in Chemistry and Masters in Accounting & Finance specialising in market anomalies.

bfinance

RBC Brewin Dolphin

Roundtable Participants

Ian Gamon
Investment Partner

Brian Leitao
Senior Investment Research Analyst

Personal Profile

Lead research partner on global equity at LCP and member of LCP's Responsible Investment team. In my day-to-day work, I advise trustees of charities and pension schemes on investment strategy and their implementation.

With over 20 years of experience as an investment consultant and actuary advising trustees of charities and pension schemes, I specialise in developing investment strategies which reflect the trustees' cashflow requirements, investment objectives and responsible investment policies.

I represent LCP on the Investment Consultants Sustainability Working Group ("ICSWG") and the Net Zero Investment Consultants initiative ("NZICI"), where I enjoy collaborating to help accelerate the transition to a low carbon economy and help meet the broader global sustainability goals.

Personal Profile

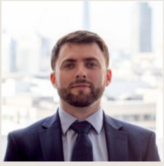
Brian works on Mercer's Manager Research team servicing OCIO, Consulting, and Wealth clients. He has experience covering equity strategies, mainly focusing on Emerging Market strategies.

Prior to Mercer, Brian has held a variety of roles in fund selection and investment research.

LCP powering possibility

Mercer

Moderator



Robert Starkey, CFA

Portfolio Manager

Personal Profile

Robert joined Schroders in May 2021 and co-manages the Schroder Investment Solutions range. He started managing multi-asset model portfolios and funds in 2013 and has experience in both the South African and UK markets.

Robert is a CFA Charter holder, holds the CIPM designation, and has passed the CFP and CAIA examinations. He holds degrees in Economics, Financial Planning, and Investment Management.

Elizabeth Pfeuti

Chief Client Officer

Personal Profile

Former Dow Jones staffer Elizabeth Pfeuti is Rhotic's Chief Client Officer and a member of the Rhotic Media executive leadership team. A highly-decorated journalist, Elizabeth has been in financial journalism for around 15 years. At Dow Jones, she covered the asset management, investment banking and investor services beats for Financial News, where she also wrote on a wide range of regulatory themes

She was previously the European Editor for CIO Magazine and boasts an exceptional contact book of buy-side and in-house institutional CIOs and asset management executives. More recently she has worked on corporate briefs for pension consultants, investment banks and asset management groups.

Schroders

RHOTIC

Dispersion in valuations in emerging markets: where are the best opportunities?

Investors are adapting to a new regime of higher inflation and interest rates as central banks switch away from quantitative easing into tightening modes in developed markets. But what does this mean for investing in emerging markets?

While the regime change outlined above is curtailing growth in developed markets, emerging markets appear to have some diverging trends. Historically of course, they have tended to have superior economic growth, but this hasn't always translated into better outcomes for equity investors.

> ***"Emerging market stocks are trading on multi-decade valuation lows against developed markets across a range of metrics"***

Today, they have stronger economic backdrops. In aggregate, emerging countries run current account surpluses, largely a result of the healthy fundamentals of Asian economies. Inflation has also been less of a problem, suggesting monetary policy can support economic growth looking ahead. Whilst the risks of recessionary forces in the West and geopolitical tensions remain, there is potential for emerging markets to offer diversification benefits to global investors. The prominence of domestic brands, self-sufficiency and reliance on consumers, who are becoming increasingly wealthier creates growth potential for investors to capitalise on. Changes in global supply chains have benefited emerging markets, such as Mexico, Poland and Vietnam, where lower labour costs provide efficient production and manufacturing bases.

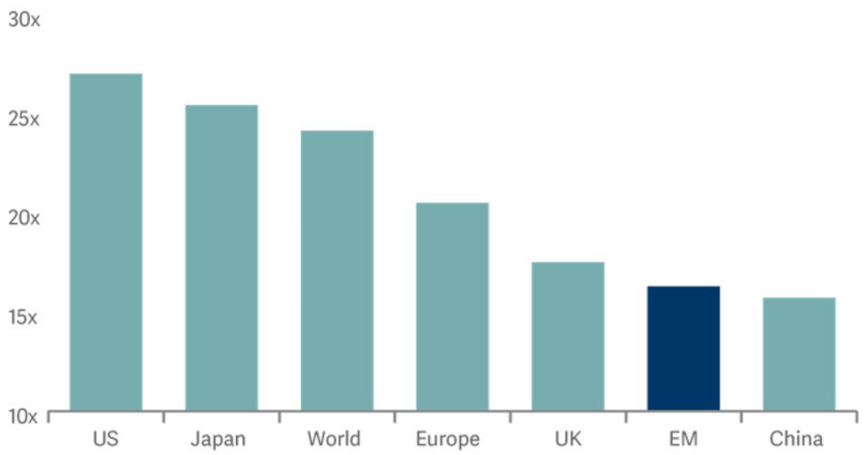
While negative sentiment about China has dominated over the last few years, the Chinese economy now appears to be in a sweet spot from an investor's perspective. The country is seeing low inflation, monetary policy in easing mode and improving economic growth from lower levels. China's reopening after the stringent Covid controls is releasing suppressed demand in all areas. Q1 GDP figures showed a strong recovery in exports and retail sales. A sustained recovery is likely to be the key determinant in changing sentiment towards emerging markets. This should lead to a better outlook for Chinese stocks, particularly given their depressed valuations \ versus history.

It's not just Chinese stocks that are valued cheaply. More broadly, emerging market stocks are trading on multi-decade valuation lows against developed markets across a range of metrics (Chart 1). They remain out of favour and extremely cheap relative to US stocks (Chart 2).

Author:

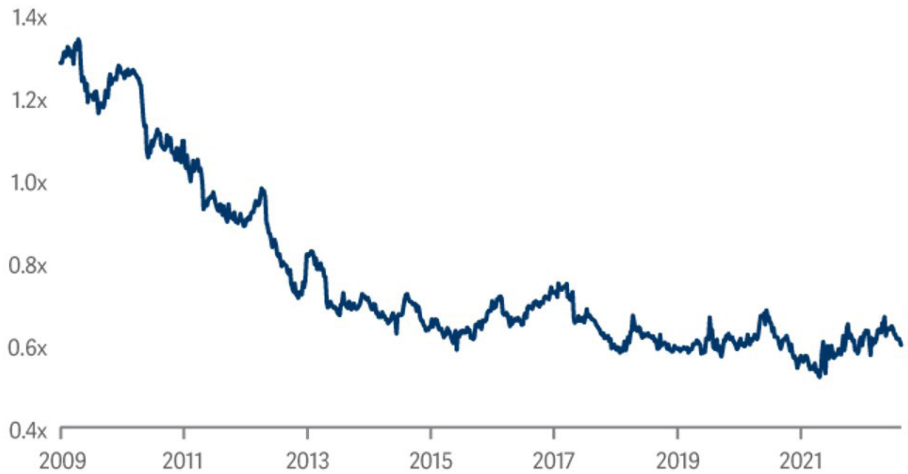
Raheel Altaf
Portfolio Manager, Global emerging Markets equity

Chart 1: Shiller P/E by region2



Source: Bloomberg as at 12 May 2023. Indices are: MSCI for EM, Asia ex-Japan, UK and Europe, S&P 500 for US and Topix for Japan Shiller P/E is the long-term price earnings ratio computed by dividing price by 10 year average real earnings per share. Real earnings per share is computed by adjusting the EPS ratio for the country's consumer price index (CPI).

Chart 2: Shiller P/E – EM versus S&P 5001



Source: Bloomberg as at 30 April 2023.

Where are we seeing the best opportunities?

For a number of years, we have seen speculation following surging share prices, which has reduced the focus on fundamentals. This has created excessively high valuations in some parts of the market that have now started to unwind.

We think this unwind has further to run and are therefore cautious on expensive companies that show signs of investor exuberance. We see less risk in companies that have been overlooked and trade on low valuations, but where there are signs of improving fundamentals.

This leads us to be overweight China, Brazil and Turkey at the country level and underweight India, Taiwan and Saudi Arabia. At the sector level, insurance, banks and energy feature as the largest overweights with materials and semiconductors the largest underweights.

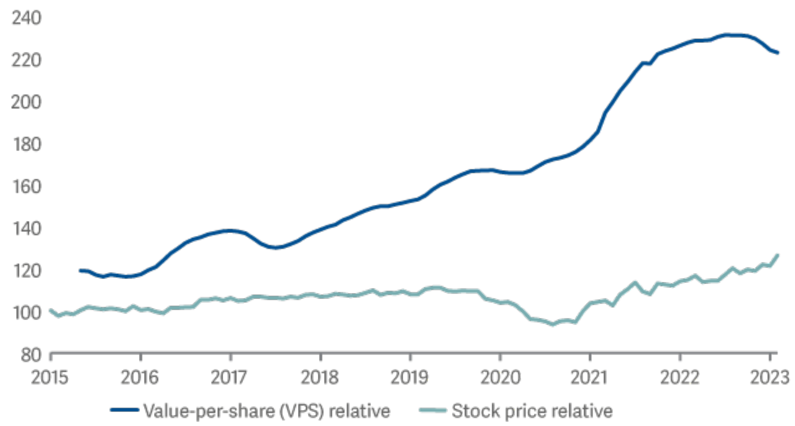
Looking at China (our largest overweight), poor sentiment has created an abundance of stock picking opportunities. One example would be amongst state-owned enterprises (SOEs). Historically, investors have been sceptical about SOEs in emerging markets and those in China have been shunned. We like selected financials and infrastructure plays in the SOE space. We think investors may be underestimating the scale of China's infrastructure efforts. In particular, the country has a strong commitment to reducing carbon emissions, having pledged to reach peak carbon emissions before 2030 and achieve carbon neutrality by 2060. We have invested in a number of renewable energy related companies in recent years, including **China Suntien Green Energy** and **Xinte Energy**.

From the perspective of the railway sector, we note that order growth across equipment players is strong and highlight **China Railway Group** as a key beneficiary for this trend. Despite this supportive growth, it trades on a much lower valuation than other Asian competitors. Recent reforms of the SOE market have also been favourable towards shareholders.

How our process identifies these opportunities

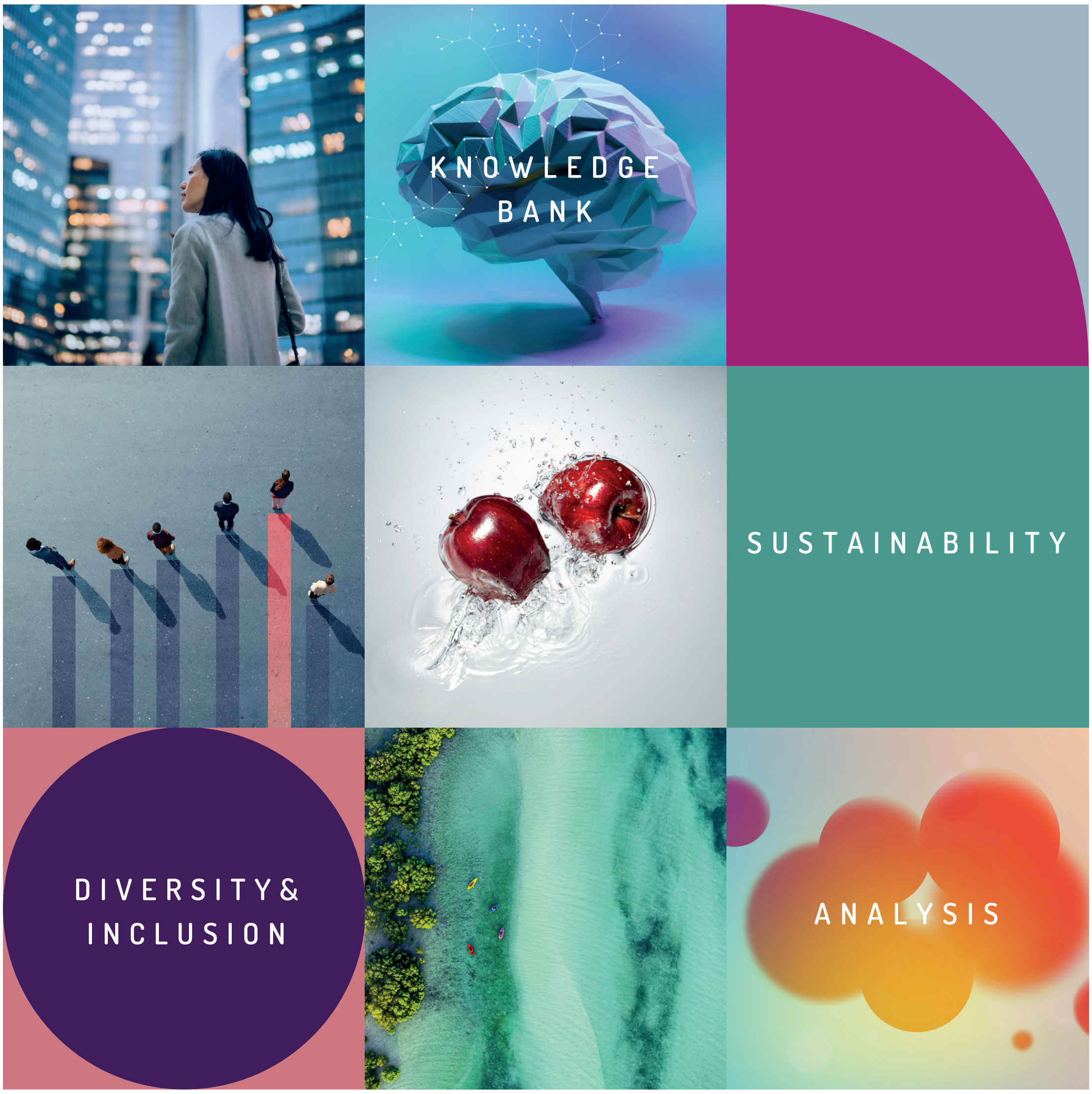
We believe that a focus on companies' fundamentals, such as earnings and cash flows, combined with a strict discipline around valuations is the best way to navigate markets. To monitor how effective we are at doing this, we track earnings, cash flows, dividends, operating profits and asset values at the company level. We can then compare the combined measure of a company's financial fundamentals (its 'fundamental value-per-share') to the broader market.

Chart 3 shows the evolution of the fund's fundamental value-per-share relative to the market and its relative performance.



Source: FactSet, Artemis, class I accumulation shares in GBP from 8 April 2015 to 30 April 2023. All figures show total returns with dividends and/or income reinvested, net of all charges. Performance does not take account of any costs incurred when investors buy or sell the fund.

The divergence between fundamentals and share prices is substantial, as shown by the wide gap between the two lines. We continue to believe that the share prices for many of our holdings are not reflective of their improving growth prospects. Our process has historically been very effective at identifying companies that deliver better growth than the market. This combination of superior growth and cheap valuations is one that we believe should reward investors in the long run.


KNOWLEDGE
BANK
SUSTAINABILITY
DIVERSITY &
INCLUSION
ANALYSIS


Disciplined core approach
+
Daily trading and rebalancing
+
Responsive to changing markets
Emerging markets experience
Learn how our experienced Global Quant team uses a nimble human centric approach seeking to uncover alpha and manage risk through various market environments.
Contact us to learn more.
Simon Bedard, MBA
Vice President, Head of EMEA
Institutional Sales & Service
Mackenzie Financial Corporation
E sbedard@mackenzieinvestments.com
MACKENZIE Investments
The palace of winds at Jaipur, India
This material is for marketing and informational purposes only and does not constitute investment advice or an offer of investment products or services or an invitation to make such offer.

A quantitative approach to inefficient markets

GLOBAL QUANTITATIVE EQUITY APPROACH

> ***"Mackenzie's Global Quantitative Equity team believes that as an equity asset class there is no place more ripe for alpha then emerging markets."***

Mackenzie's Global Quantitative Equity team believes in a core style of investing that employs fundamental ideas through a disciplined, risk-aware investment approach in seeking to generate alpha within global markets. The team, led by 30-year quantitative industry veteran, Arup Datta, uses several of the same elements that a fundamental manager uses, however his team utilizes a systematic process to analyze more factors and stocks than a traditional fundamental manager. The team adheres to a core focus which aims to produce a more consistent alpha profile through and across multiple market environments. In addition, they believe that their daily stock analysis and proprietary transaction cost estimation along with a focus on capacity management, sets them apart from a number of their competitors. A quantitative lens, aided by computing power, sophisticated algorithms and adaptive models, provides the team with a measurable process to value securities across the broad investment universe.

Balance of factors

Through a quantitative lens, the investment team constructs portfolios with a "core" focus, which aims to provide a balance between growth and value characteristics and seeks to outperform in various market environments. The investible universe is viewed within a region/sector/industry relative model framework. Within each of the four regions, stocks are measured against sector and industry peers.This model framework yields a matrix (by region, sectors and industries) in which each stock is categorized and ranked in a region-based peer group.

Each stock is adjudicated against 15-20 factors broadly grouped into four "super factors" consisting of Value, Quality, Revisions and Informed Investor. A balanced weight is assigned to these super factors at the portfolio level; however, weights vary by individual stock. Within Value, the team places emphasis weight between Quality Value (cash flow and dividend-based valuations). Pure Value (earnings, book and gross profit-based valuations) and including innovative ways at looking at valuations. The Quality factor balances management actions such as capital allocation, operating efficiency, ESG, employee sentiment and use of accounting practices; it also includes notions of management quality. The Growth factor refers to analyst revisions to forecasts (earnings, sales and dividends), long-term growth, innovation and insights from linked companies. While the Informed Investor factor analyzes informed market participant activity, such as short interest in and option pricing on securities.

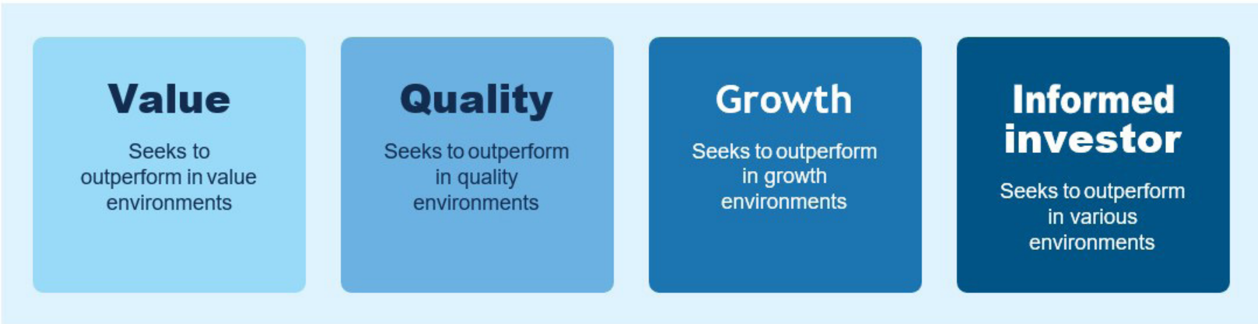
Author:

Arup Datta, MBA, CFA
Senior Vice President, Head of Global Quantitative Equity Team

MACKENZIE Investments

Beyond the four Super Factors, contextual variables are applied to determine the weight of factors for each stock. The contextual model incorporates a sophisticated approach to weighting, as the efficacy of factors vary based on underlying stock characteristics. A human overlay at extremes, such as a three-sigma event, is employed for factor weighting during periods of market dislocation. For instance, the team employed a value-tilt based during the early stages of the global pandemic based upon a three-sigma opportunity and unwound the tilt as the spread in valuations came in.

FIGURE 1 – BALANCED APPROACH TO FACTORS



Expand the universe, daily trading, and a focus on capacity management and strong implementation

The investment team manages their flagship strategy, Mackenzie Emerging Markets All Cap, to the MSCI Emerging Market IMI Index, which has approximately 3,200 index constituents. The team expands upon the index constituents to include more than 10,000 securities within their investable universe. For fundamental managers, a typical analyst would be responsible for having a deep understanding of, at most, 30-50 companies. To successfully cover such a broad emerging markets universe, fundamental managers must employ a large team of analysts. The process of expanding the investable universe beyond benchmark constituents is in place for all of the investment strategies managed by the team.

The team strongly believes that there is an advantage in daily portfolio rebalancing and trading. A quantitative approach allows the investment team to be nimble and incorporate daily changes in stock alpha forecasts for the entire investment universe, which allows the team to rapidly and efficiently trade in and out of stocks. This more frequent incorporation of new information helps generate the freshest alpha potential into the portfolio, but this is only possible with a strict focus on capacity management and efficient trading. The team has placed limits on the asset size of their strategies to maintain nimbleness for portfolio trades.

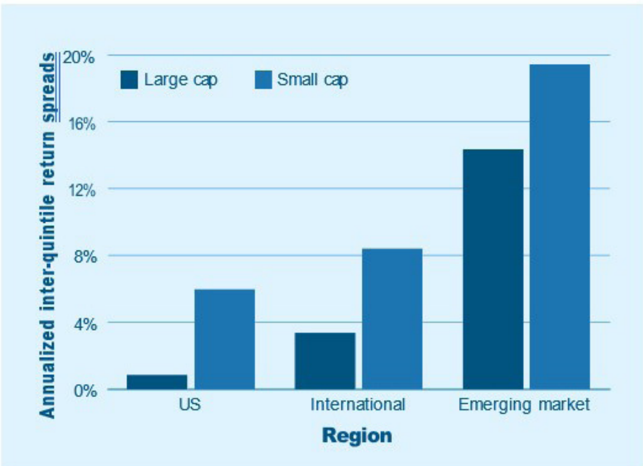
Another critical consideration when investing in emerging markets is relatively high trading costs when compared to developed markets. The same is also true in less efficient small-cap securities versus higher liquidity large-cap companies. In seeking to deliver alpha efficiently, the team has constructed a sophisticated transaction cost model which is used in conjunction with the alpha model as part of the investment process. The model helps the team quantify the trading impact of each security by measuring round-trip transaction costs (market impact, commissions and stamp duties). Trading volume demanded and volatility are key drivers of the team's market impact cost model.

Fertile ground for alpha

Mackenzie's Global Quantitative Equity team believes that as an equity asset class there is no place more ripe for alpha then emerging markets. The chart below depicts a simple factor-based analysis of portfolios that blend stocks with both value and momentum characteristics. The results of this simple analysis clearly show the potential alpha opportunity in emerging markets and the added benefit of a small cap focus. In the flagship strategy, Mackenzie Emerging Markets All Cap, the team positions the portfolio to attempt to extract alpha in mid and small-cap stocks, an area that is particularly rich in alpha potential.

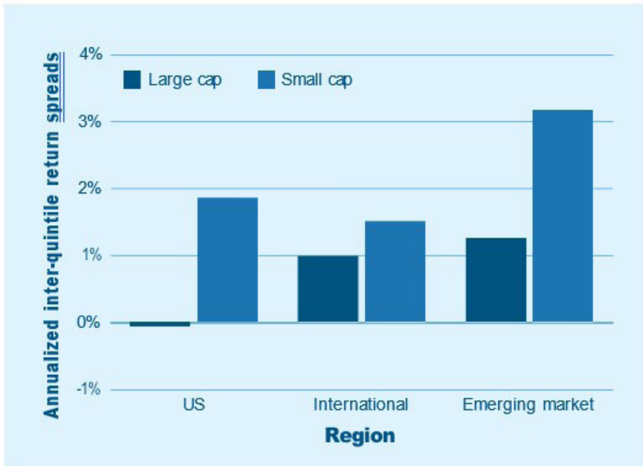
The benefits of emerging markets and small cap stocks can also be seen on a realized basis. The chart below serves as evidence that emerging markets as an equity asset class, coupled with a tilt towards small-cap stocks, truly has the potential to generate alpha over the long-term. The team also sees this small-cap advantage to be evident in their international and US portfolios as well.

FIGURE 2 – QUANTITATIVE ALPHA EFFICACY



Represents inter-quintile return spreads using 50/50 blend of Value and Momentum from September 2002 – December 2022

FIGURE 3 – MEAN BENCHMARK-RELATIVE EXCESS RETURN FOR ACTIVE MANAGERS 2012-2022



Source: eVestment Universes. Returns shown represent past performance, are not a guarantee of future performance and are not indicative of any specific investment. Please note that the benchmark for the strategies within each universe vary, excess performance of active strategies is based on managers preferred benchmark.

Conclusion

At Mackenzie, we believe that emerging market equity, as an asset class, is often overlooked for the wrong reasons. From a total asset allocation standpoint, emerging markets continues to represent only a small portion of most plan sponsors equity allocations. We view the asset class as a critical component of the equity allocation puzzle. While emerging markets has encountered high volatility historically, we maintain a strong belief in the growth rate potential in the companies and countries within the emerging markets and the long-term return and diversification benefits of a broad-based allocation. We believe, that the opportunities are plentiful within a broad emerging markets investment universe and through a disciplined, risk-controlled investment process, as employed by Mackenzie's Global Quantitative Equity team, successful security selection in emerging markets can be achieved. We see similar opportunities for harvesting alpha by applying our disciplined process to more inefficient small-cap universes in emerging, international and US markets.

Emerging Markets: Suits you

How emerging market companies are becoming increasingly tailored.

> *" Investment spending priorities are shifting towards delivering resilience."*

Battling for market share

What do you think of when someone mentions emerging markets? High growth? Cheap valuations? Geopolitical risk? Cutting edge technology? A broad sweep of sustainable investing opportunities?

When I look at Emerging markets, I see high growth opportunities married with relatively cheap valuations. I see young populations, more than 80% of the world's total, living on three-quarters of the world's land mass. I also see young companies battling for market share across regions whose investment spending priorities are shifting. That shift is towards delivering resilience, through diversification of suppliers, power sources, and customers, with the goal of bringing about sustainable growth.

Yet, it's also true these markets in aggregate tend to perform better when global growth is buoyant, and worse when it is not. So, with talk of recession does the case for emerging markets still add up?

A cyclical relationship

Emerging markets' cyclical relationship with the rest of the world can be looked at through two key lenses:

- **The case for resources:** Emerging Markets supply large amounts of global metals and hydrocarbons, which are in greater demand as global economic growth and investment spending picks up.
- **The case for people:** Emerging Markets have younger populations, so their potential contribution to economic growth in terms of labour is greater than the aging and relatively smaller populations of developed markets. But that higher economic growth potential needs more funding than an emerging market alone can supply, so these countries tend to borrow from others. This leaves emerging markets geared to a cycle of whether foreign investors are accommodating or otherwise.

Author:

Will Scholes
Co-fund Manager of the newly launched Premier Miton Emerging Markets Sustainable Fund

Headwind, lull, or tailwind?

In 2022, a strong US dollar and the Federal Reserve's interest rate rises were headwinds for emerging markets. A stronger dollar makes borrowing conditions harder for many emerging market governments and companies, and coupled with higher interest rates, can also discourage capital investment in 'riskier' markets like emerging markets.

Premier Miton INVESTORS

It is unlikely 2023 will see these headwinds repeat to the same degree. As the Fed is expected soon to finish raising interest rates, the bar for the dollar to climb further in value seems high. This could prove to be a boost to emerging markets which were negatively impacted by these two correlated factors last year. What is more, emerging economies seeing inflation falling faster than many developed nations, in part because they could not afford the sort of Covid-19 support schemes witnessed in wealthier nations. That means scope to cut interest rates sooner and support economic growth.

Global investment spending priorities may be a good fit for Emerging Markets
Emerging markets may be buffeted by global trade in the short run, but a more powerful structural driver is global investment spending. That spending is returning and changing in nature to the benefit of the emerging markets bloc. For instance, Latin America is a key exporter of copper, lithium and graphite which are crucial for electrification and energy storage. Likewise, Indonesia is a large and growing exporter of nickel which is a crucial metal in battery technology. The case for resources remains strong.

What about the case for people?
Taiwan exports billions of dollars in semiconductor products and services and is likely to benefit from a step change in data demand brought about by generative artificial intelligence (AI). India remains a powerhouse in IT services. And of course, China's lead in the manufacturing chains of solar modules, wind turbines, electrolysers and battery recycling may yet prove too great to be overcome. While tensions between the US and China over trade continue the resulting supply chain shift away from China may benefit other emerging economies. Mexico has received help from 'near-shoring' to the US, and foreign direct investment there is at decade highs. Other beneficiaries of shifting supply chains include India, Malaysia, Vietnam, and countries across the European periphery. Where China is losing, other emerging market countries are gaining. And a dollar taken out of a factory in China and reinvested in these countries carries more weight given the smaller relative size of those nations' economies.

Putting the customer first – a sustainable competitive advantage
One feature of a business we prioritise when looking for investments is customer-centricity. This is a broad area that I would define as working as closely as possible with customers to establish a mutual reliance.

Companies refer to this in different ways, be it 'small batch manufacturing' or 'high customisation' or 'high mix, low volume.' But the essence is the same, that market incumbents, who are often branded firms suffering from high cost inflation, need to mitigate those pressures through standardisation of product.

Emerging market companies, by contrast, are not only integrating themselves as manufacturers of products of increasing complexity as developed market firms look to migrate to service relationships but are also happily embracing bespoke projects rather than rejecting them.

Contract manufacturing – a question of trust
Outsourcing to a third party where processes are highly capital intensive can be enormously efficient, such as with semiconductor manufacturing and the so-called 'pure foundry' model established by Taiwan Semiconductor Manufacturing Company (TSMC). The rationale behind this being that it is better to have a single billion-dollar factory run at full capacity by a single trusted third party, than have several billion-dollar factories operating in-house at lower levels of utilisation. There are pitfalls however for the developed world: give up too much control, as we have seen with solar cells, and you may never regain it.

Customer centricity case study: Voltronic

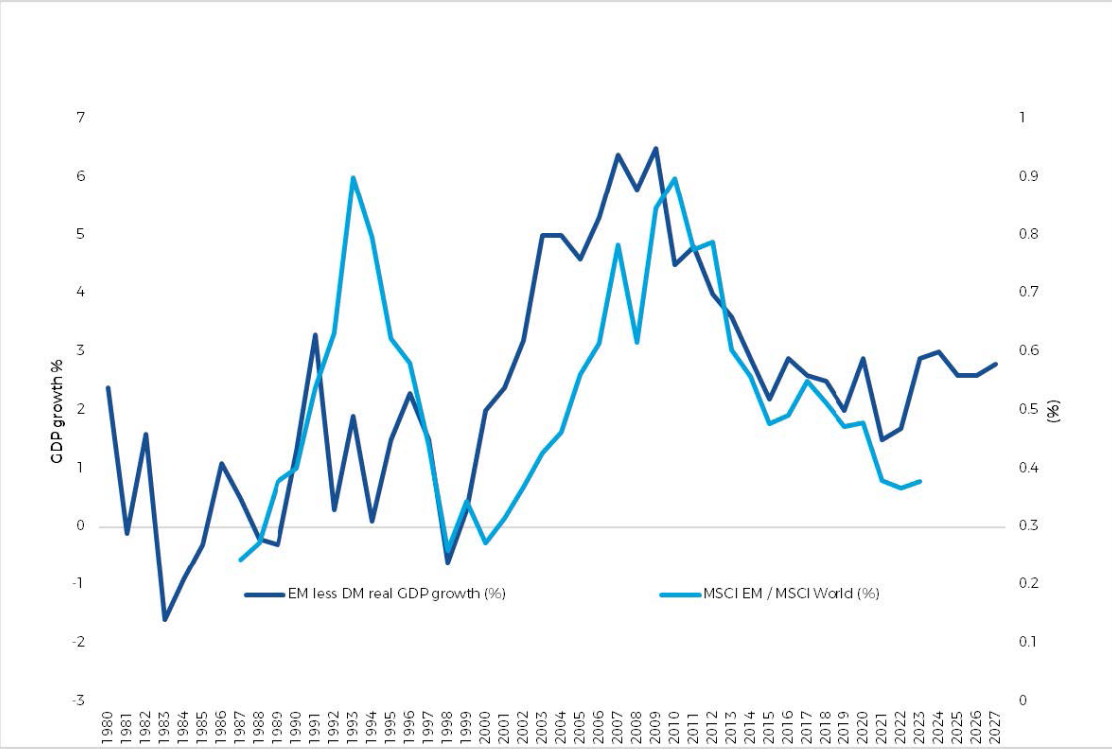
Another Taiwanese firm has successfully carved its niche in the design and manufacture of uninterruptible power supply (UPS) devices, and inverters. Inverters manage the flow of current, while UPS devices maintain the consistency. In a world requiring higher electrification, more dispersed and intermittent sources of electrical power, and the charging of electric vehicle batteries at home or on the street, Voltronic's product portfolio is attractively positioned. These aren't simply for electric vehicle drivers in the western world; some of Voltronic's biggest customers last year were found in South Africa where power cuts continue to plague households and businesses, and in Pakistan in the wake of devastating floods in 2022.

However, you'll never see Voltronic's name on these products. Buy a UPS device from market leader Schneider Electric, and there's a high chance it was made by Voltronic. Developed market incumbents in these industries are changing their business models: from manufacture of product to more consulting work and passing over product portfolios to companies like Voltronic. This isn't delegation, it's acknowledgement of specialist expertise and trust: Voltronic manufacture not only for Schneider, but most of the top global vendors of UPS products from the United States to Japan. That takes mutual trust and expertise, not just price, and Voltronic's returns on invested capital – 46% in 2022 – reflect that.

The bigger picture for emerging markets

Regional equity performance vs relative GDP growth

Globalisation has peaked. Reconfiguring the world economy for resilience will doubtless bring challenges and require large scale investment, but it will also offer huge opportunities to a broad range of emerging markets. Long term investors naturally expect GDP growth to be higher in emerging economies than in developed countries. This 'growth differential,' which acted for years as a strong positive catalyst for foreign flows and equity returns and a pre-requisite for emerging markets out-performing developed market equities, is once again on the rise according to IMF forecasts. Exciting times lie ahead.



Source: IMF Forecasts data from 1980 to 2027 (forecast).

Important Notice

This document is produced by CAMRADATA Analytical Services Limited ('CAMRADATA'), a company registered in England & Wales with registration number 06651543.

CAMRADATA is neither authorised nor regulated by the Financial Conduct Authority in the United Kingdom nor the Securities and Exchange Commission in the United States of America.

This document is a marketing documentation and is not intended to constitute an invitation or an inducement to engage in any investment activity. It is not intended to constitute investment advice and should not be relied upon as such. It is not intended and none of CAMRADATA, its holding companies or any of its or their associates ('With Intelligence Group') shall have any liability whatsoever for (a) investment advice; (b) a recommendation to enter into any transaction or strategy; (c) advice that a transaction or strategy is suitable or appropriate; (d) the primary basis for any investment decision; (e) a representation, warranty, guarantee with respect to the legal, accounting, tax or other implications of any transaction or strategy; or (f) to cause the With Intelligence Group to be an advisor or fiduciary of any recipient of this report or other third party.

The content and graphical illustrations contained in this document are provided for information purposes and should not be relied upon to form any investment decisions or to predict future performance.

CAMRADATA recommends that recipients seek appropriate professional advice before making any investment decision.

Although the information expressed is provided in good faith, the With Intelligence Group does not represent, warrant or guarantee that such information is accurate, complete or appropriate for your purposes and none of them shall be responsible for or have any liability to you for losses or damages (whether consequential, incidental or otherwise) arising in any way for errors or omissions in, or the use of or reliance upon the information contained in this document. To the greatest extent permitted by law, we exclude all conditions and warranties that might otherwise be implied by law with respect to the document, whether by operation of law, statute or otherwise, including as to their accuracy, completeness or fitness for purpose.

CAMRADATA Analytical Services Limited and its logo are proprietary trademarks of CAMRADATA and are registered in the United Kingdom.

CAMRADATA
With Intelligence
One London Wall
London
EC2Y 5EA

+44 (0)20 7832 6500
camradata.com

Join us on LinkedIn