

# Emerging Markets: A perennial let-down or will 2022 be the breakthrough year?

November 2021



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Alquity

## Mike Sell

### Head of Global Emerging Market Equities



- Joined Alquity in 2014
- 25+ years of experience investing in Emerging Markets equities
- Partner at Thames River/Nevsky Capital. Mike was part of the team that helped grow the EM equity assets from US\$150m to US\$3.5bn
- Moved to F&C with the long only EM business in 2011

## Kieron Kader

### Associate Portfolio Manager



- Joined Alquity in 2019
- Previously, Emerging Markets equity analyst at BP - one of the largest pension funds in the UK

# Topics for today

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# 2021 – The year that was



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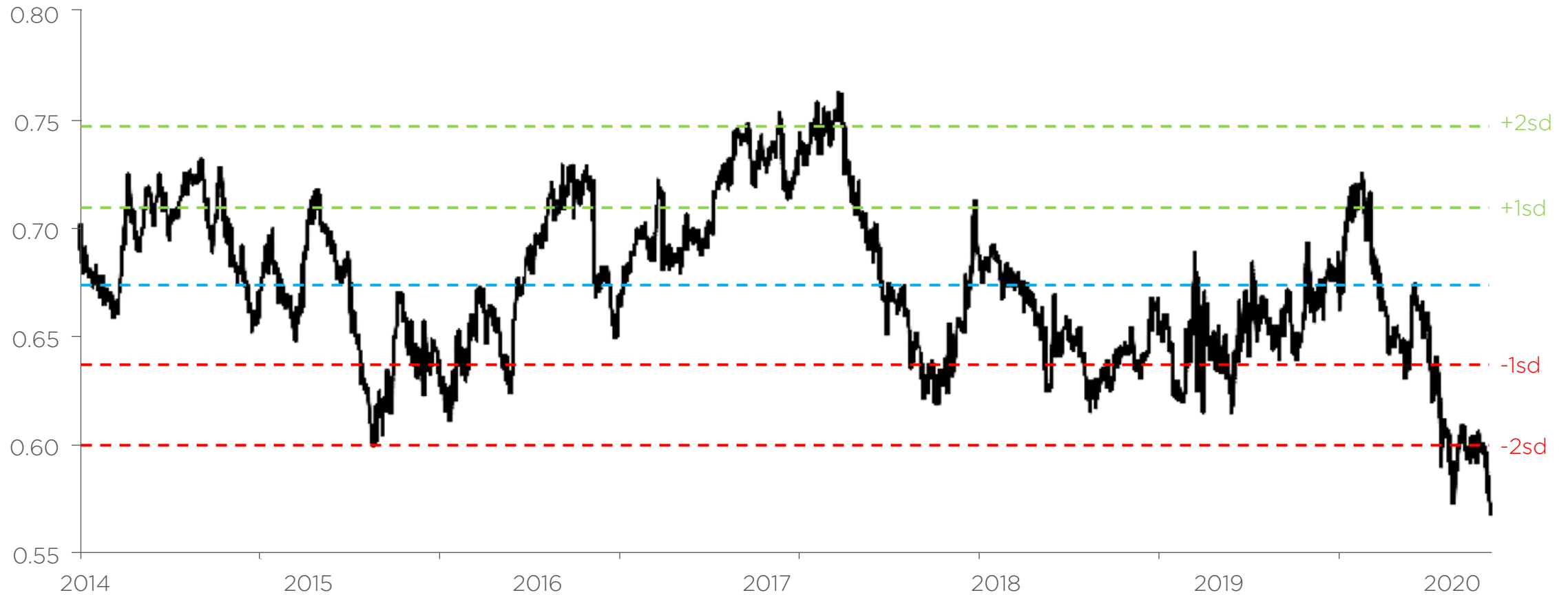


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# Emerging Markets are at multi-year low valuations...

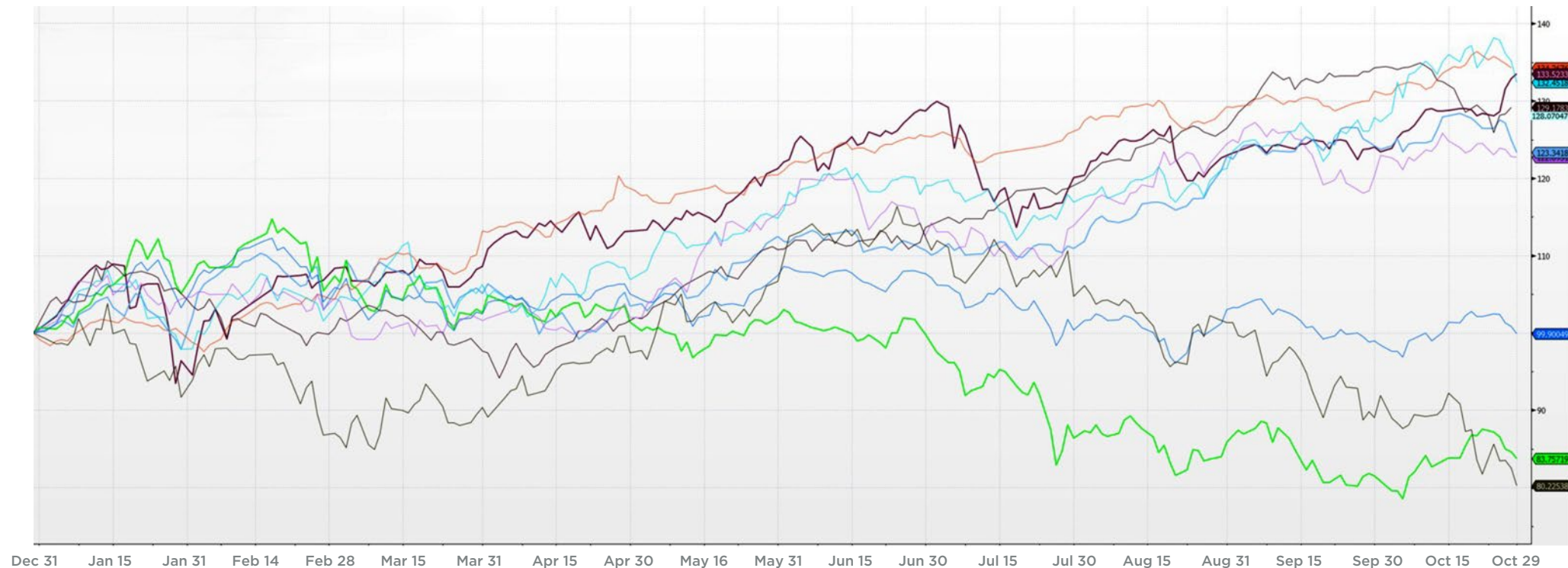


Relative EM to DM trailing P/B since 2014



... but this masks a wide divergence in returns

### YTD performance across EM indices (\$)



<b>EM Index:</b> -0.27%	<b>China:</b> -16.25%	<b>Brazil:</b> -19.18%	<b>India Nifty 50:</b> 23.34%	<b>Vietnam:</b> 33.52%	<b>Bangladesh:</b> 29.18%	<b>Saudi Arabia:</b> 34.27%	<b>Hungary:</b> 22.69%	<b>Russia:</b> 32.45%
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# How did we do in this environment?



**Alquity Future World** (GEM): +4.4%

EM index: -0.3%

**470 bps outperformance; Top Quartile versus peers**

Key Drivers:

- Underweight China & Korea
- Chinese, Indian & Korean Stock Selection
- Out-of-index Singaporean internet position

	Volatility ranking – Future World Fund
1Y	101/269
3Y	214/237

**Alquity Asia**: +6.6%

Asia ex Japan Index: -2.2%

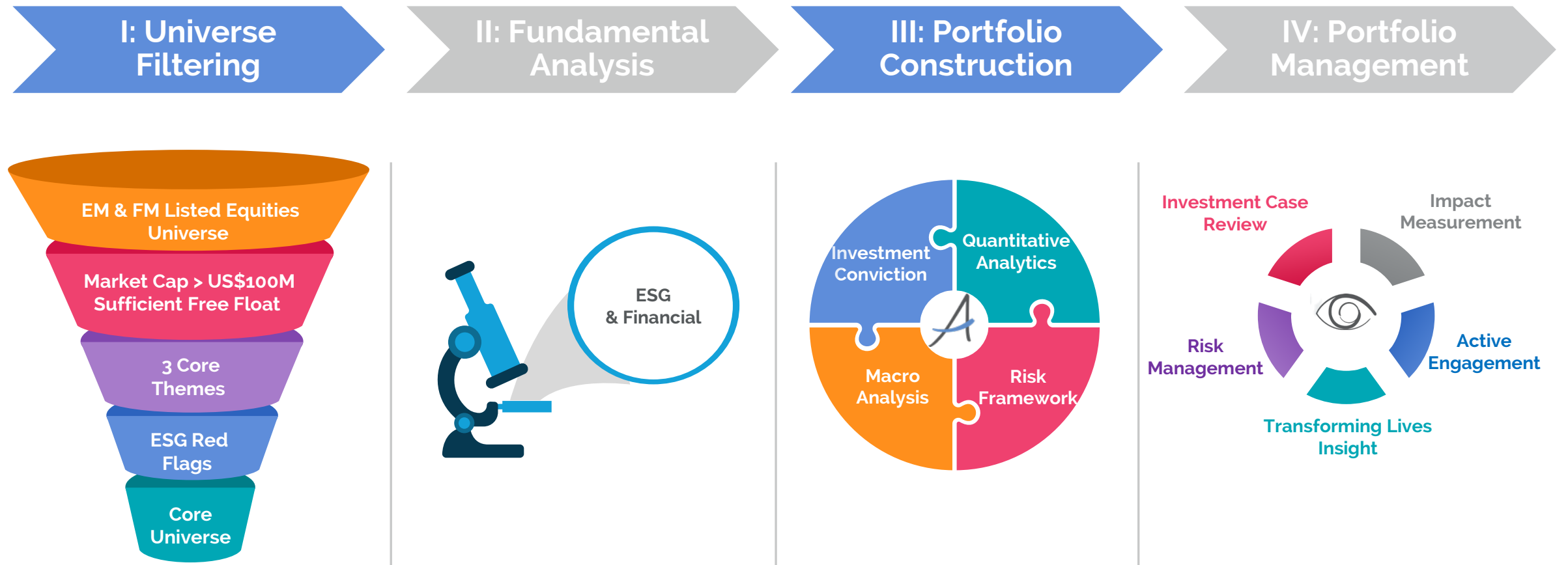
**880 bps outperformance; Top Quartile versus peers**

Key Drivers:

- Underweight China & Korea
- Chinese, Indian & Korean Stock Selection
- Vietnam

	Volatility ranking – Asia Fund
1Y	81/180
3Y	158/166

# How did we achieve this?





# Where are the hidden opportunities in 2022?



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# Catalysts for Emerging Markets in 2022

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- ✓ Benign global economic backdrop
- ✓ Above trend GDP growth for Emerging Markets (5.1%)
- ✓ Cheap valuations
- ✓ Reduction of China risk (external and domestic; macro and political)
- ✓ Increased investor focus on smaller markets

# Where do we see long term growth opportunities?

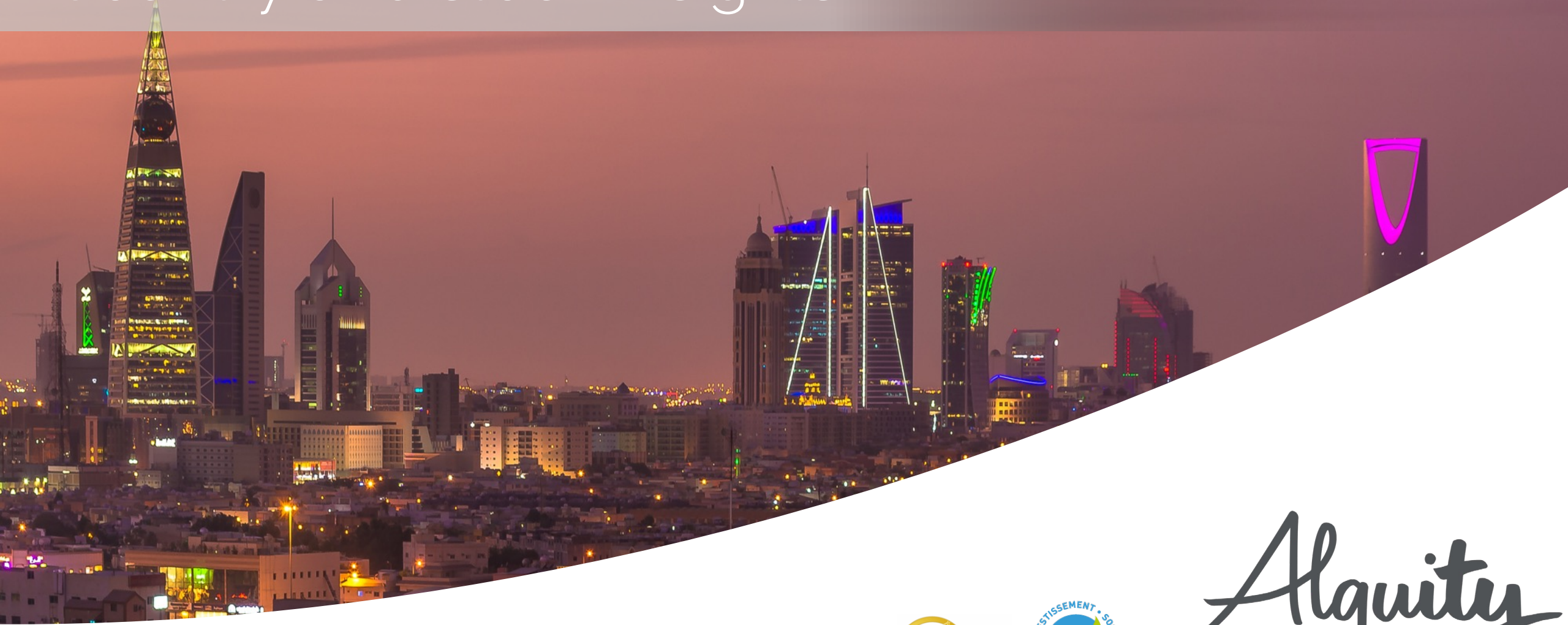


**Domestic, structural growth themes** typically represent approximately 75% of our portfolios:

- 1) Shift from the informal to formal economy
  - India, Mexico, Pakistan
- 2) The move from a physical to a digital world
  - China, Korea, Morocco, Singapore, Poland
- 3) Decarbonisation
  - Century Iron (Taiwan), Delta Electronics (Taiwan), Copper
- 4) Urbanisation
  - Vietnam, Indonesia
- 5) Demographics
  - Saudi Arabia, Mexico and much of Asia



# Country and stock insights



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# Indonesia: stable macro backdrop underappreciated



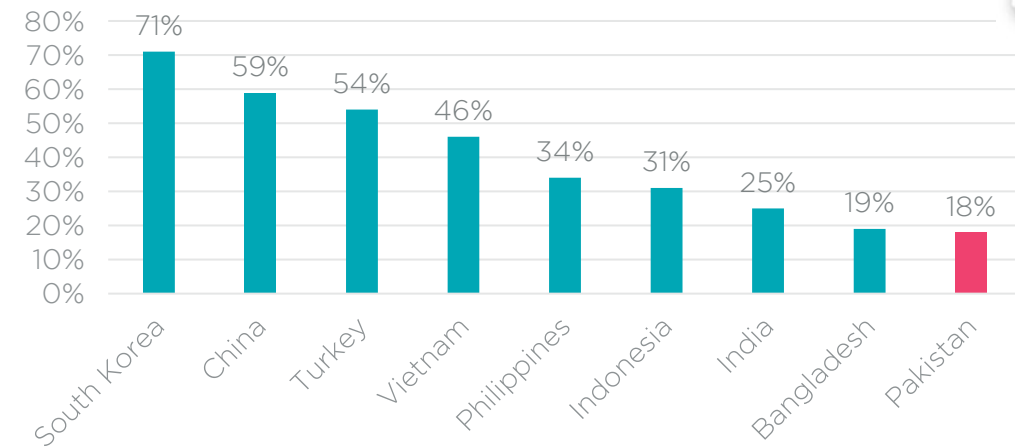
- Covid cases finally shrinking & economy re-opening
  - October PMI 57.2 (vs 52.2 in September and 43.7 in August)
  - Expect GDP growth of 5.2% in 2022
- Inflation at just 1.7% in October; large output gap will allow Bank Indonesia to leave policy rate unchanged
- Current account deficit has shrunk to 1.5% GDP vs pre-pandemic levels, helped by commodities
- Strong fiscal position and stable political backdrop allows for further structural reforms and infrastructure spending
- Valuations are 1 standard deviation below 20 year average (trailing P/B)
- **MAPI**, **Kino** and **Indocement** are key positions (all ESG C rated), aligned to our domestic, structural themes such as demographics and urbanisation

# Air Link: not yet discovered by investors

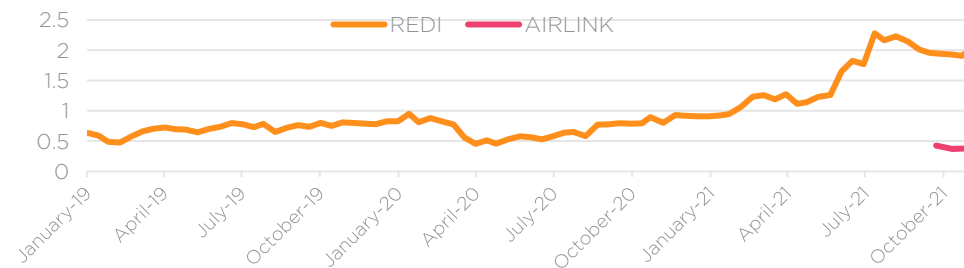
- Leading Pakistani distributor, retailer and manufacturer of mobile phones
- Recently listed; met initially in 2018
- Long term growth potential due to underpenetrated market
- Beneficiary of digitalisation and shift to formal economy; not factored into valuations
- ESG rating: C



## Smartphones as % of population



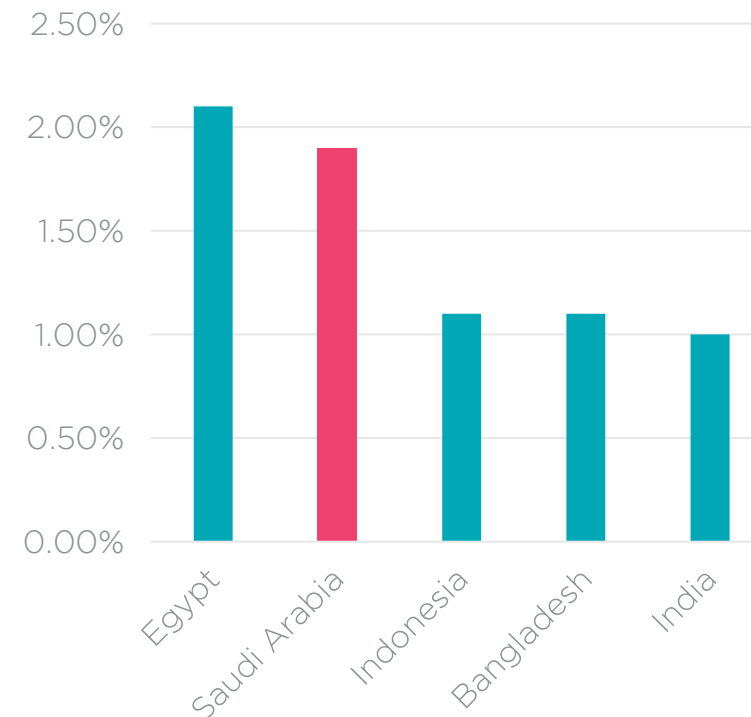
## Performance of peers provides context



# Saudi Arabia: wrongly ignored

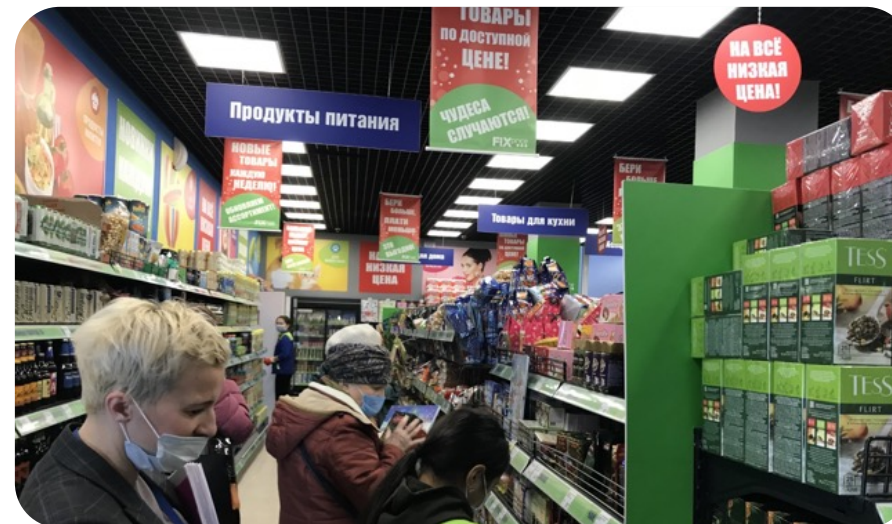
- Population of 34.8M people, rising rapidly – links to our theme of demographics
- Vaccination rate of 69.8%; our channel checks highlight the return to normality
- Cyclical tailwinds (oil accounts for 24% of GDP in 2019) as well as structural growth
- We focus on banking, property and retail

**Population growth p.a. over the last 5 years**



# Eastern Europe: hidden winners from retail digitalisation

- **CCC** (ESG rating A)
  - Leading shoe retailer (30% market share in Poland)
  - Transformation into an omni-channel business not appreciated
  - Expanding throughout Europe (in 29 countries)
  - 50%+ discount to peers



- **Fix Price** (ESG rating C)
  - Leading Russian discounter (90% market share), with 4753 stores
  - First mover – competitive advantage plus structural growth from downtrading
  - Strong ‘moat’ against e-commerce





# Latam: opportunities in Mexico, mounting risks in Brazil



Mexico

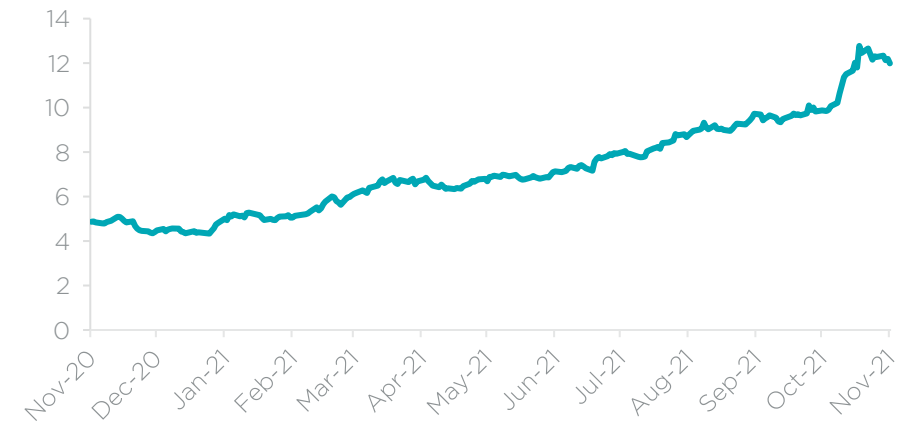
- Key themes of 1) favourable demographics 2) the shift to an organised economy
- US cyclical recovery, with a higher oil price are further tailwinds
- Walmex and Asur are our preferred Mexican names (ESG ratings of B and A respectively)



Brazil

- Brazilian fiscal risks continue to mount
- Political risks are growing ahead of October 2022 election
- The SELIC rate has increased from 2% to 7.75% this year, with a peak of 12% expected

**Brazil 2-year Sovereign Bond Yield (%)**







# China and India



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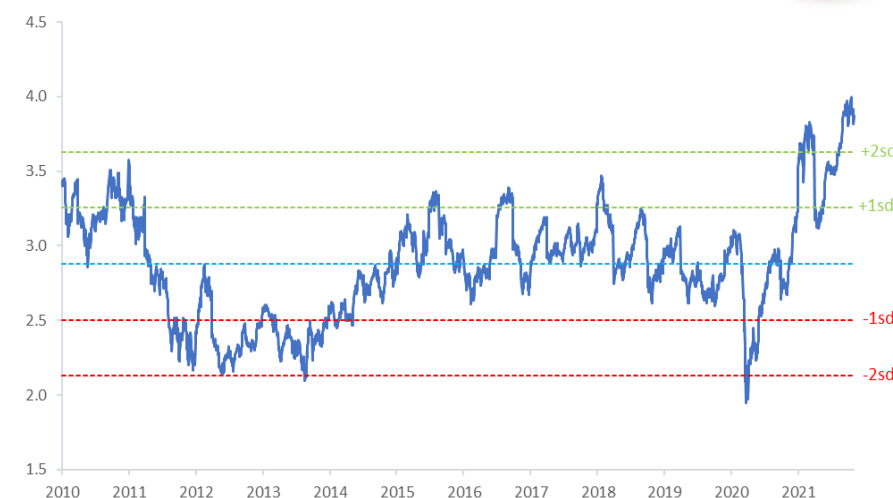


# India: Strong rebound in activity, with inflation contained



- Strong rebound in activity
  - Economy re-opening
  - Successful monsoon (third consecutive year)
- 9%+ GDP growth expected this year, combined with controlled inflation and accommodative monetary policy
- Current account will move into only a modest deficit (c.1% of GDP) due to oil
- Valuations look rich, but justified by the strong recovery and long term growth themes (demographics, shift to formal economy)
  - **Banks**, Tractors (**Escorts** – ESG B rated) and **Hero Motor** (B rated) are our preferred exposures
  - Keep an eye on Uttar Pradesh elections in Feb/Mar 2022

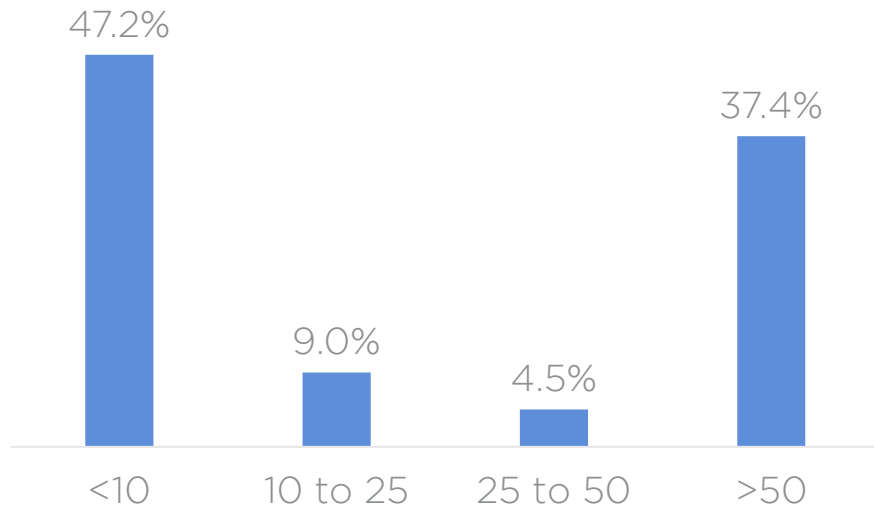
India Equity Market – P/B ratio



# Alquity India Fund – successfully focusing on the long term themes



## Market capitalization split



## Morningstar Percentile

	YTD	1Y	3Y	5Y	Since inception
Morningstar Percentile	1.1	1.9	52.6	27.8	14.6



# China: Multiple issues hit the headlines in 2021

- **Regulatory crackdown** - began in the tech sector, but now 'perceived' as an ideological campaign
  - Restrictions on foreign IPOs, anti-monopoly investigations, constraints on private tutoring, demand for charitable donations...
- Crisis at **Evergrande** has led to concerns over broader financial contagion
  - However, most large developers are not on the brink of a liquidity crisis and fears of a sector collapse are overdone
- **Power rationing**
  - Energy shortages are now starting to ease
- Pursuit of a **zero-COVID strategy**
  - But, China's high vaccination rate should allow it to shift to a less disruptive strategy in time



But the bad news is the price



Has the turnaround started?

- Our portfolio naturally focuses on lower risk areas:
  - We screen out 38.5% of companies
  - Insurance, Retail, Internet vs Manufacturing & SOEs
  - Renewables are a double-edged sword
- HK listed companies have best in class sustainability disclosure
- President Xi targets peak carbon emissions by 2030 and carbon neutrality by 2060
  - Helpful backdrop for our corporate engagement



## Reasons for Exclusion at Alquity

- ✗ Governance failings (including corruption, conflicts of interest, etc.)
- ✗ Poor treatment of workers
- ✗ Product quality failings (e.g. food safety)
- ✗ Pollution incidents
- ✗ State Owned Enterprises: is the company run for the benefit of minority shareholders or the government? e.g. China Mobile, SMIC



# Our unique proposition



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## ESG: Label ISR – a clear differentiator

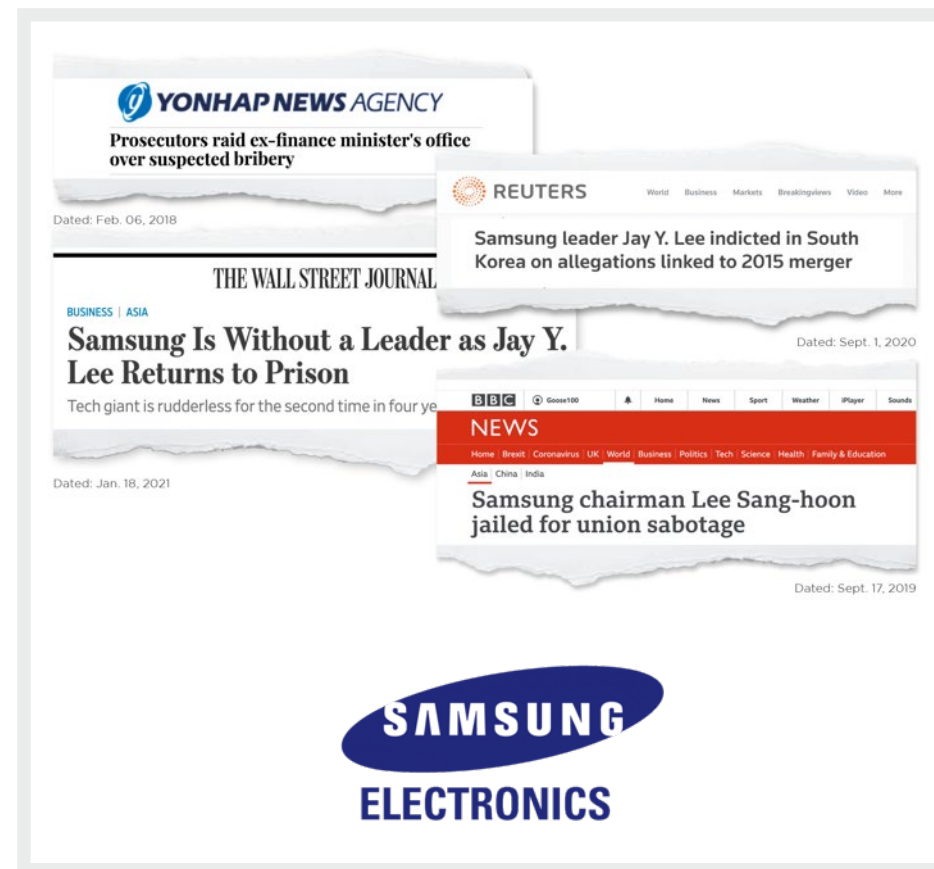
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# We do not compromise: Samsung Electronics is an ESG FAIL



- 4<sup>th</sup> largest weighting in the MSCI Emerging Markets index
- Popular holding in so-called 'sustainable' funds
- But a multi-year pattern of **criminality**
  - Jay Y Lee – jailed & released; under investigation for further accounting fraud and stock price manipulation
  - Lee Kun-Hee (father) – convicted twice
  - Lee Sang-Hoon (no relation, independent ex-Chairman) – convicted
  - Jae-Wan Bahk (current independent Chairman) – under investigation
- 6 / 11 Directors are allegedly independent. Box ticked...?  
... but lightweight Board; look to TSMC as a comparison...



# The next chapter- the confluence of ESG and impact



## Incorporated in our process:

- Key Progress Indicators
- Engagement
- Alquity Transforming Lives Foundation



## Our portfolios generate lower GHG and use less water than their respective indices

	FW	Index*	Asia	Index*	India	Index*
GHG (tons of CO <sub>2</sub> e / \$M)	223.6	379.7	233.6	406.4	399.6	610.2
Water Usage (m <sup>3</sup> / \$M)	946.8	9520.9	1078.8	7481.7	1170.3	12316.8

- The big 4 Asian markets represent 75% of the Asia Fund vs as much as 95% for certain peers
  - These ignored smaller Asian markets encompass 969 million people
- The big 6 EM markets represent 63% of the Future World Fund vs as much as 88% for certain peers
  - We are invested in 21 markets currently, providing broad EM exposure and extensive diversification
- Small & mid cap stocks represent 32% of the Asia Fund (index weight of 5%) and 30% of the Future World Fund (index weight of 6%)
  - Controlled exposure and consistent source of alpha generation



# Alquity: Higher returns combined with cheaper valuations



Alquity Asia	2022	2023
Portfolio P/E	21.3	19.9
Index* P/E	28.3	35.4
Portfolio ROE	21.5%	21.8%
Index* ROE	16.0%	16.6%

Alquity Future World	2022	2023
Portfolio P/E	20.7	18.6
Index* P/E	26.3	32.3
Portfolio ROE	20.1%	20.6%
Index* ROE	17.1%	17.8%

Compelling for all investors

# Conclusion

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- ✓ **Growth tailwinds** to persist; EM is clearly **cheap** and has catalysts
- ✓ We are thematic investors; **themes** run throughout our funds
  - Our portfolios are not just a collection of stocks
- ✓ We believe in **ESG**; this is not a bolt-on to our process
- ✓ We have a real **impact**
- ✓ We are **differentiated** – smaller markets & stocks; domestic focus
- ✓ We are **fundamental** – delving beyond the headlines to find hidden opportunities
- ✓ We are **delivering** across our product range



# Appendix



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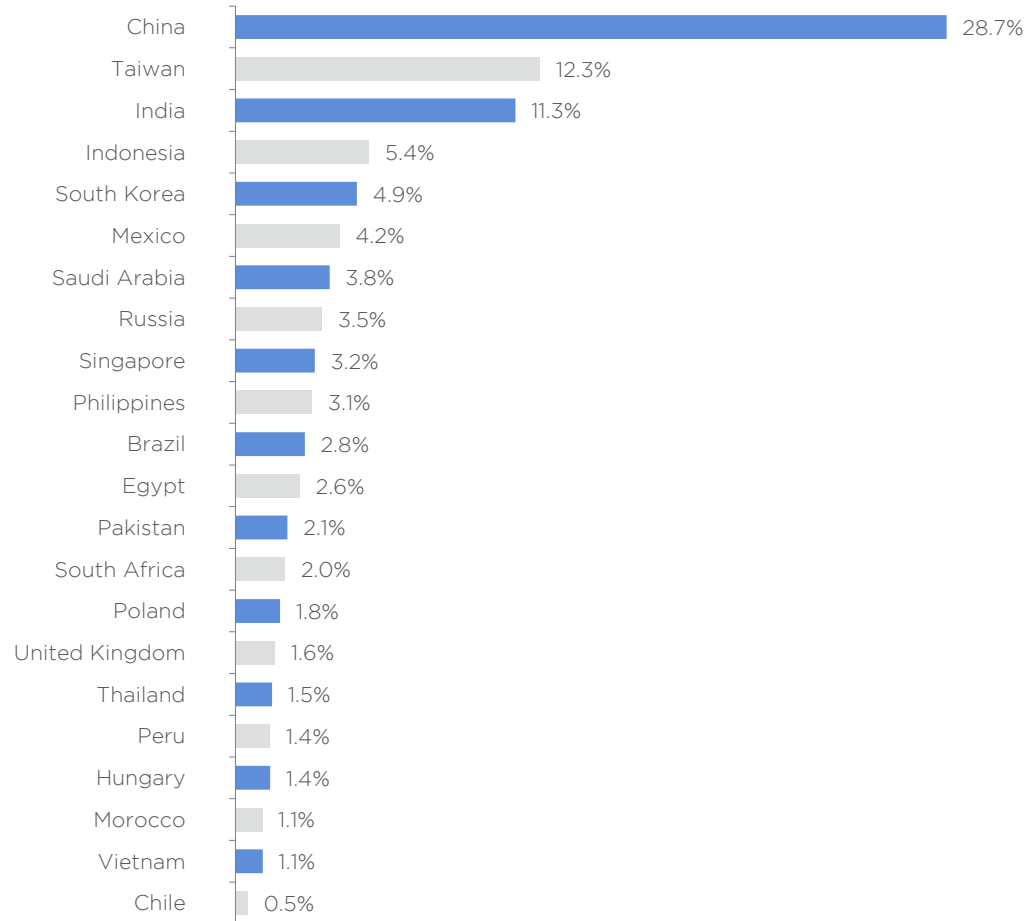
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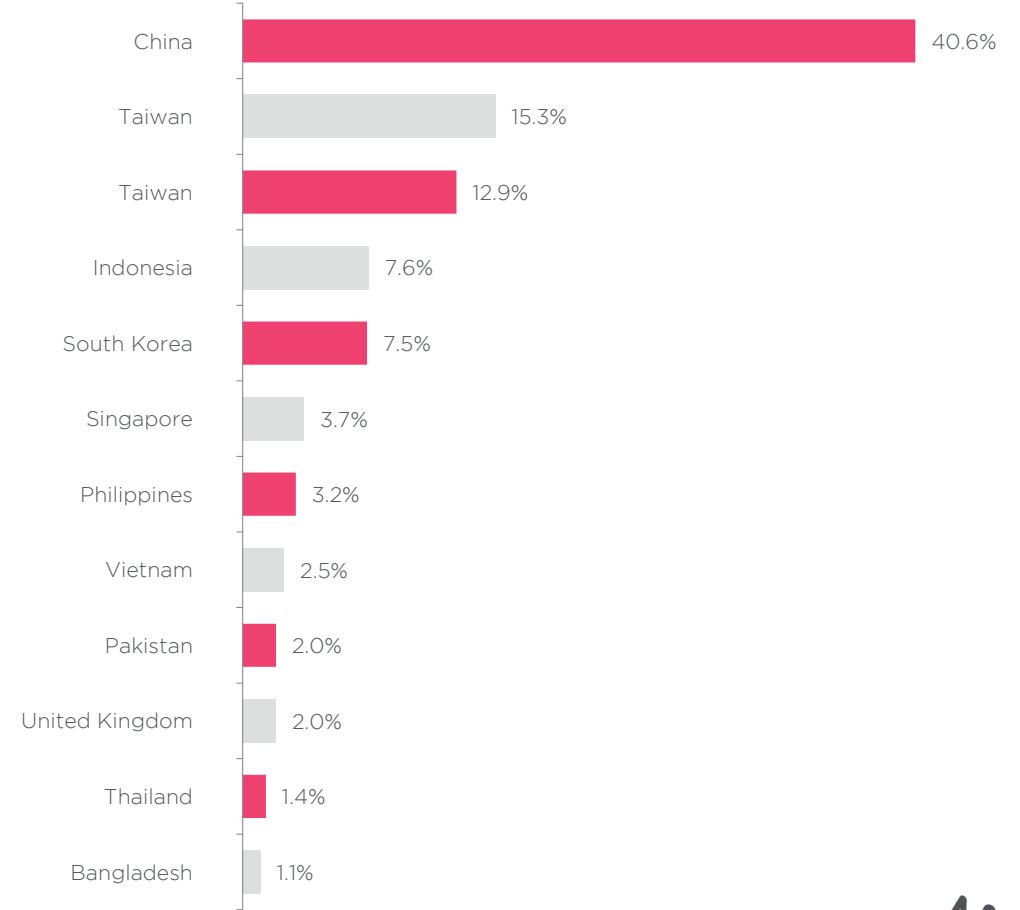
# Country allocation: focused on domestic growth and competitive advantage



## Alquity Future World



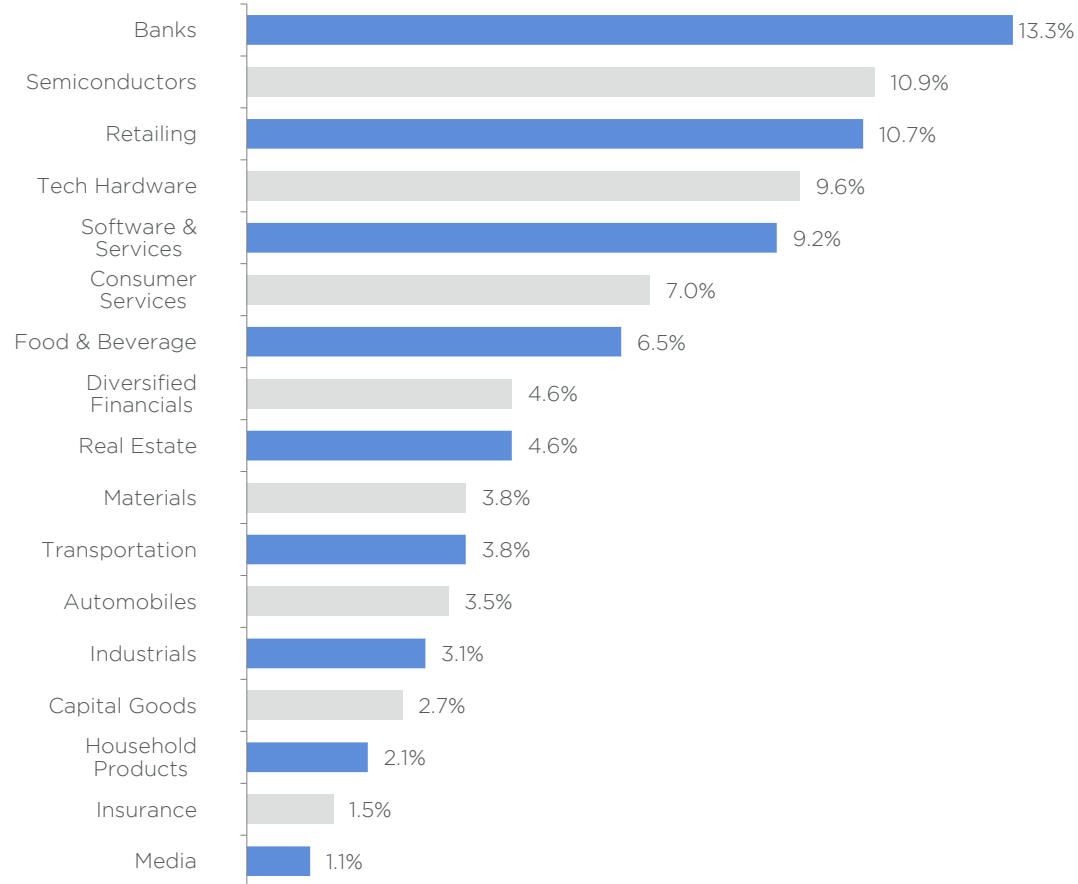
## Alquity Asia



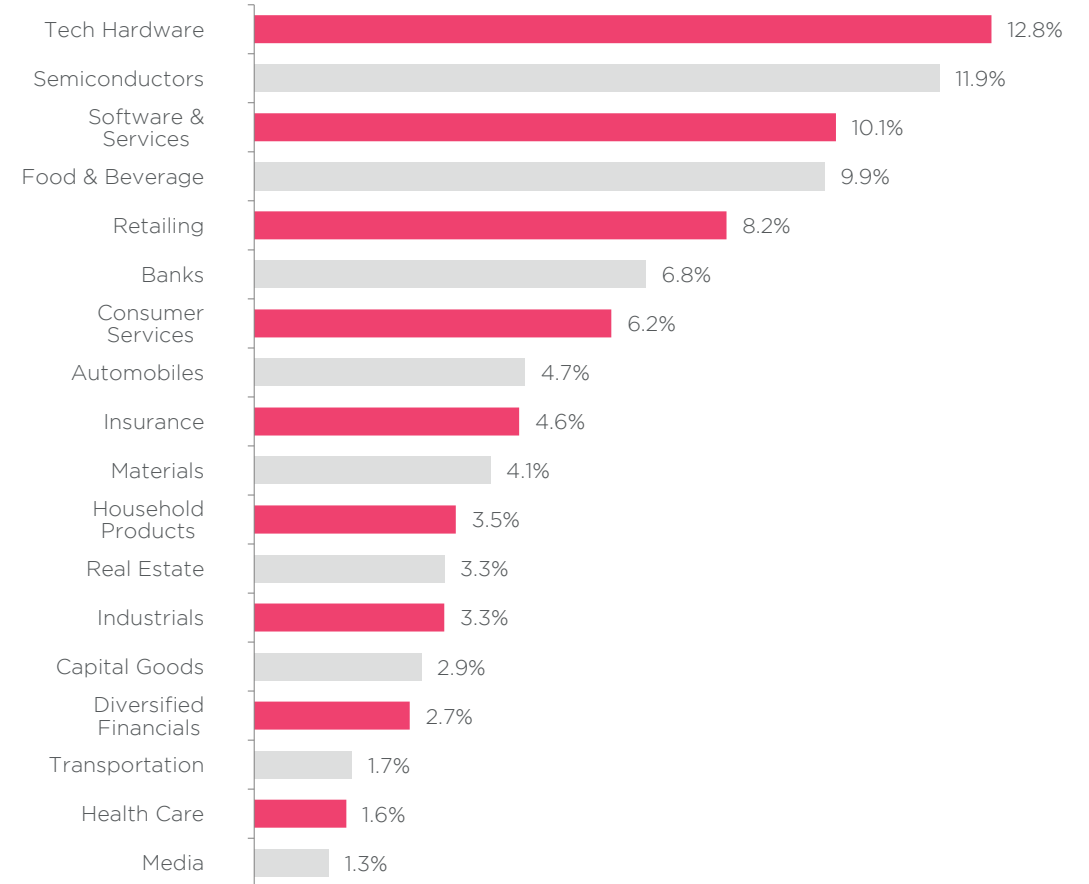
# Sector allocation: focused on structural growth trends



## Alquity Future World



## Alquity Asia



# Top 10 Holdings: Conviction and high quality ESG drives holdings



Alquity Future World	
TSMC	6.4%
Tencent	6.3%
Meituan Dianping	2.5%
HDFC Bank	2.4%
SK Hynix	2.2%
ASUR	2.2%
China Pacific Insurance Company	2.1%
Saudi British Bank	2.1%
Yongda Auto	2.0%
Walmex	2.0%

Alquity Asia	
Tencent	7.1%
TSMC	6.8%
Meituan Dianping	3.0%
Hong Kong Exchange	2.7%
SK Hynix	2.7%
China Pacific Insurance Company	2.6%
Kakao	2.5%
HDFC Bank	2.4%
SEA	2.3%
Yongda Auto	2.1%

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