EMERGING MARKETS EQUITY INVESTING:

ALQUITY FUTURE WORLD FUND

Why the Alquity Future World fund represents the ideal combination of skills and expertise needed to invest in Emerging Markets

The grouping of countries under the heading of Emerging Markets (EM) is the investment equivalent of describing wines as fermented grape juices. Whilst the description is accurate at a basic level, it clearly ignores the huge range and uniqueness that wines from different regions possess. To really understand EM, like wine you have to treat each region and country on its own merits, identifying strengths and risks without making sweeping generalisations. So, **what are the key attributes EM investors must possess to be successful in this eclectic and dynamic asset class?** We have highlighted a few of them below using our Future World Fund as an example:

SEE THE WOOD AND THE TREES

It is often stated that EM investors should be based **"on the ground"** to fully understand the context and issues facing the economies, which in turn allows for more informed decisions. As stated earlier, EM are such a varied mix of economies and cultures, where would "on the ground" actually be? Large asset managers may at this stage point to having teams in every market. This sounds impressive until your job as a Portfolio Manager is to piece together all this information into a cogent investment strategy. The risk is that you literally become a "manager" trying to maintain consensus, rather than a focused investor. Instead, the question should be, how do you make the best, fact-based investment decisions consistent with your fund strategy?

At Alquity, that is done by having a single **multi-disciplinary team** working together and pretty much co-located (although due to Covid, one of the team is US based for the moment). Travelling into different countries for company site visits and wider research allows the team to assess each country on what they see and hear rather than through a "home" country bias. In addition, the team shares a **consistent investment process** that incorporates quantitative analysis alongside fundamental research to ensure investment conviction is holistic on each country and holding.

> ***How do you make the best, fact-based investment decisions consistent with your fund strategy?***

LEARN FROM THE PAST TO PREDICT THE FUTURE, SOMEWHERE ELSE

Every country is on a unique trajectory determined by its history, geographical make up and political context. But that doesn't stop some countries from sharing some common developmental characteristics. The skill is being able to translate learning from one country's experience into that of another country's future path. Using this skill allows Alquity to **identify opportunities ahead of time rather than waiting for the trend to appear**. For example, our Head of Global Emerging Markets Mike Sell has over 25 years of experience of investing in Asia with a deep knowledge of how India has developed over that time. He can now see the same developmental characteristics in countries like Bangladesh helping us identify target investments ahead of peers.

Mike Sell,
Head of GEM

ESG AS A FLEXIBLE TOOL NOT A SLEDGEHAMMER

It is very easy to take a developed world version of ESG investing and apply it to every company in the same way. It makes life a lot easier for ESG ratings agencies, especially if you want to sell "one stop" solutions to investors. This "sledgehammer to crack every nut" approach, ignores any economic or social context which produces a **developed market blind spot**. In practice, it is important to apply ESG flexibly, but by maintaining minimum standards to avoid accepting severe and universal ESG violations.

We do this in our Future World Fund in the following ways:

1 High and Low Risk ESG industry classification

High risk industries are those that emit significant amounts of GHG emissions through their operations. As emissions count the same towards climate warming wherever they are produced, we take a **global view assessing these companies against global standards** if they want to achieve our A rating. For low-risk industries, we take a regionally based approach, comparing performance to peers operating in a similar context to determine our A-C rating.

2 Red Flags

In addition to sector exclusions, we have identified business practices that fall below our **minimum standards in any context** and so are able to ensure our holdings meet globally accepted standards such as the principles enshrined in the **UN Global Compact**. We also focus on critical environmental issues such as avoiding commercial fishing and strictly enforcing palm oil supply standards.

3 Linking ESG risk directly to valuation

Our ratings allow our **valuations to be adjusted to reflect the material impact of ESG risk**. We also incorporate carbon transition risk for some industries such as cement, aviation and shipping. By increasing the equity risk premium we reflect the significant impact the transition may have on future revenue and profits in these high GHG emitting sectors.

DATA BEATS GUT INSTINCT EVERY TIME

Some countries within Emerging Markets have a lot of romance about them and it is very easy to get emotionally connected to them and also some of the iconic companies associated with them. The key is to interrogate that feeling with facts that support objective investment decision making. At Alquity, we do this by supporting our investment team with **independent macroeconomic analysis** provided by our Macro strategist Keith Gyles.

Keith Gyles,
Macrostrategist

Using real data, we are able to make judgements on how different countries compare and where to make or switch allocations. In addition, hard data on stock volatility and correlation is used to **ensure portfolio construction does not inadvertently add risk from a single sector or over-reliance on a single factor** such as oil price for example. Our Quantitative Analytics team led by Marnie Aragon-Uy is a critical contributor to this input into the investment process.

Marnie Aragon-Uy,
Head of Quantitative Analytics

NEW OPPORTUNITIES WHERE OTHER DO NOT LOOK OR CANNOT LOOK

Every Emerging Market asset manager will say that they are able to uncover new opportunities that others can't find. They will typically talk about teams of expert analysts scouring annual reports, research papers and attending conferences. The Future World Fund takes a more direct and simpler approach. Firstly, we don't separate Emerging Markets from Frontier Markets, which allows us to find companies in smaller, developing economies that others, well just ignore. Secondly, **we use our Transforming Lives projects to generate new ideas and develop insights inaccessible to traditional asset managers**. For example, our team ran a consumer panel with Phool, an India based social enterprise that provides dignified employment for women from the lowest castes. They are new members of the up-and-coming consumer class in India and our panels help us understand their priorities, concerns and how they make spending decisions. This information helps shape our research agenda which then informs the highly selective holdings in the portfolio.

2022 promises to be an exciting year in the Emerging Market asset class but it will not be plain sailing. There will be challenges and bumps in the road, but we believe that the team and strategy we have developed for the Future World Fund is well placed to **deliver strong risk adjusted returns, through a responsible portfolio that also contributes to a just, climate transition**. As a consequence, Future World is a unique "net positive" Emerging Market fund.

Future World is a unique "net positive" Emerging Markets fund

Suresh Mistry

Head of ESG and Impact Reporting

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The Fund's investment approach is long-term, investors must expect to be committed to the Fund for an extended period of time (3-5 years) in order for it to have an optimal chance of achieving its investment objectives.

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