

# EMERGING MARKETS: IS THE WORST NOW BEHIND US?

June 2022



LIFE CHANGING INVESTMENTS

*Alquity*

# Presenter

## MIKE SELL

### Head of Global Emerging Market Equities



- 25+ years of experience investing in EM equities
- Partner at Thames River/Nevsky Capital. Mike was part of the team that helped grow the EM equity assets from \$150m to \$3.5bn
- Moved to F&C with the long only EM business in 2011
- Since joining Alquity in 2014, Mike has been able to build on his experience to drive the development of our ESG process across Emerging Markets

# Agenda

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# AROUND THE WORLD IN SIX SLIDES

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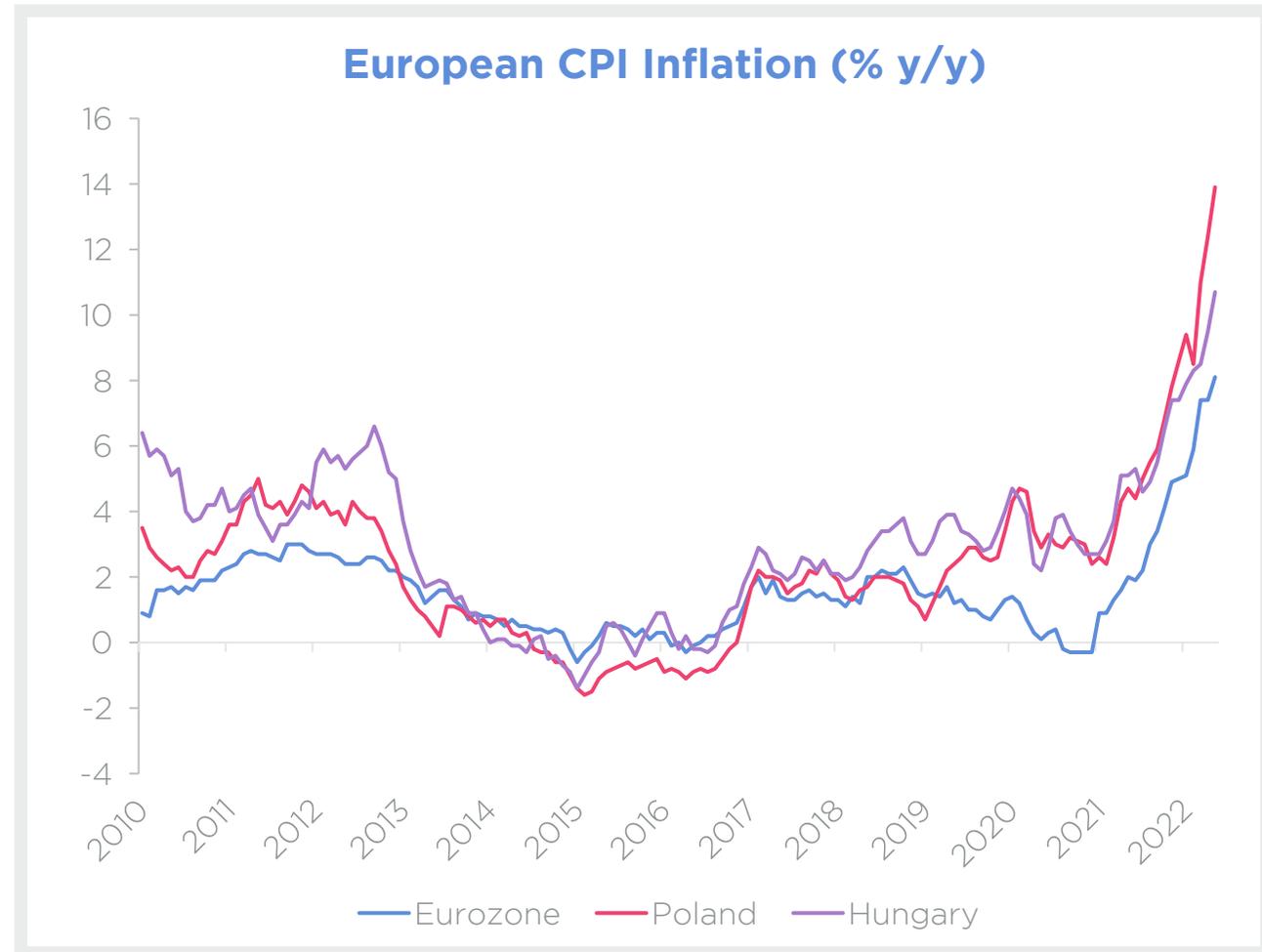
# An extended peak for US inflation, but Fed hikes aggressively priced

- 175-200 bp additional Fed Funds hikes priced for this year



## Meanwhile, in Europe....

- **Eurozone inflation continues to surge** as energy prices rise due to the Ukraine war
- **ECB** to end asset purchases and start **hiking interest rates** in July, possibly with 50bp move, whilst attempting to mitigate pressure on peripheral country spreads
- **Eastern European countries** already well into **aggressive hiking cycles**, despite risks to growth from energy supply disruptions
- With inflation yet to peak, **more aggressive tightening is still required**
- **We have just one position:** CCC (Poland), A rated



# Latam – A beneficiary of higher commodity prices?

**Yes, but political risk** is a more important consideration and so just **8% of our Future World Fund**



**Brazil** – General election October 2022



**Mexico** – Rolling back market reforms



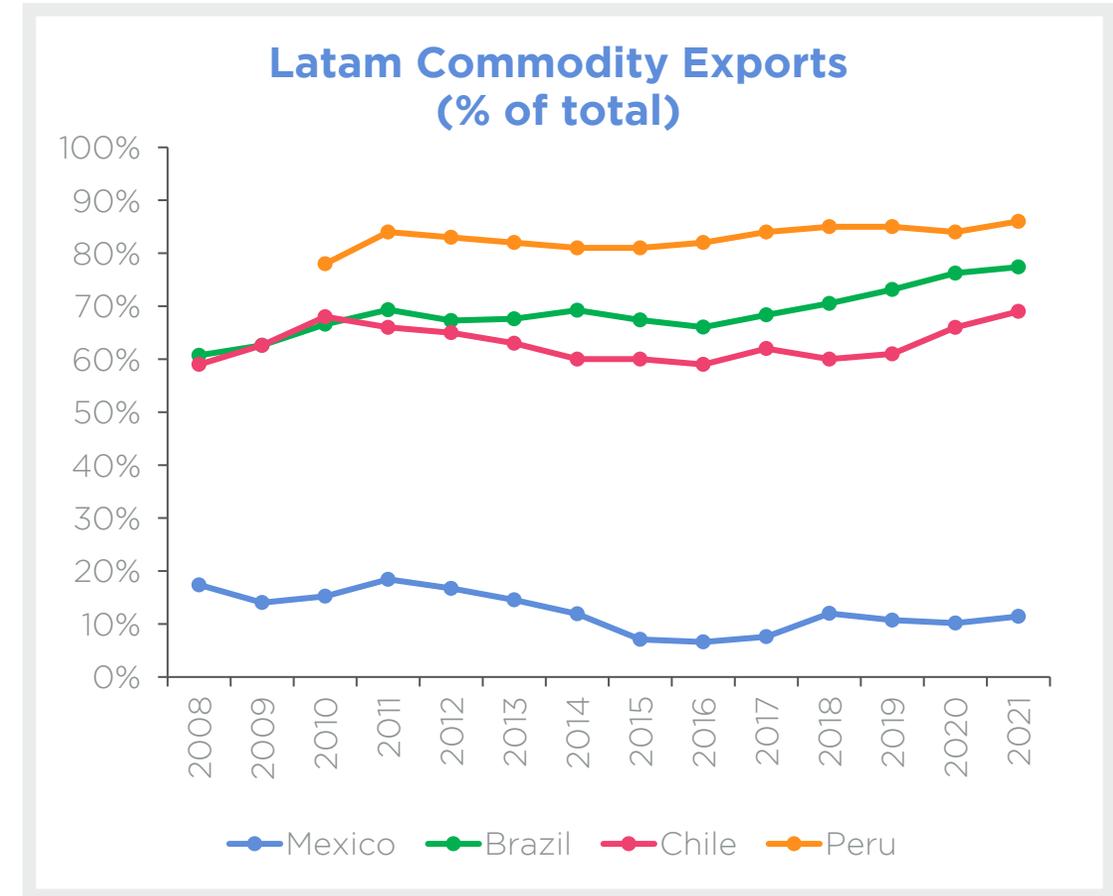
**Chile** – Constitutional referendum September 2022



**Peru** – Impeachment risk for President Castillo

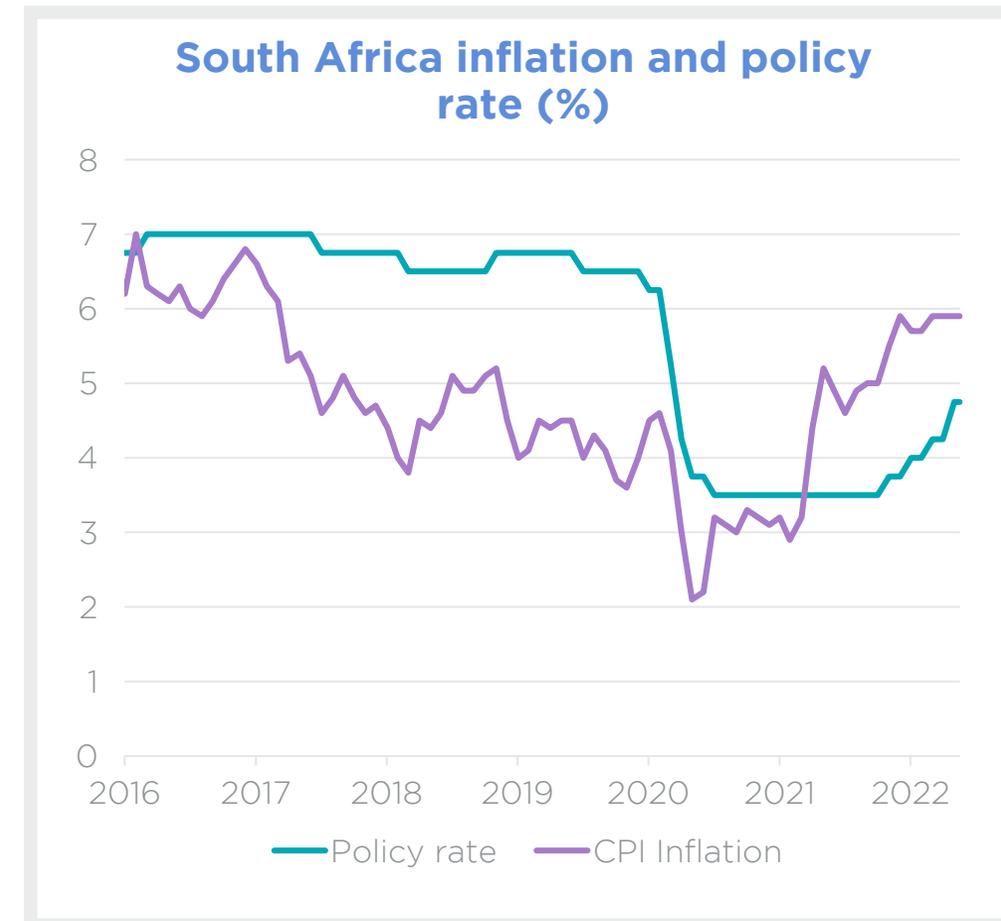


**Colombia** – Polarised politics



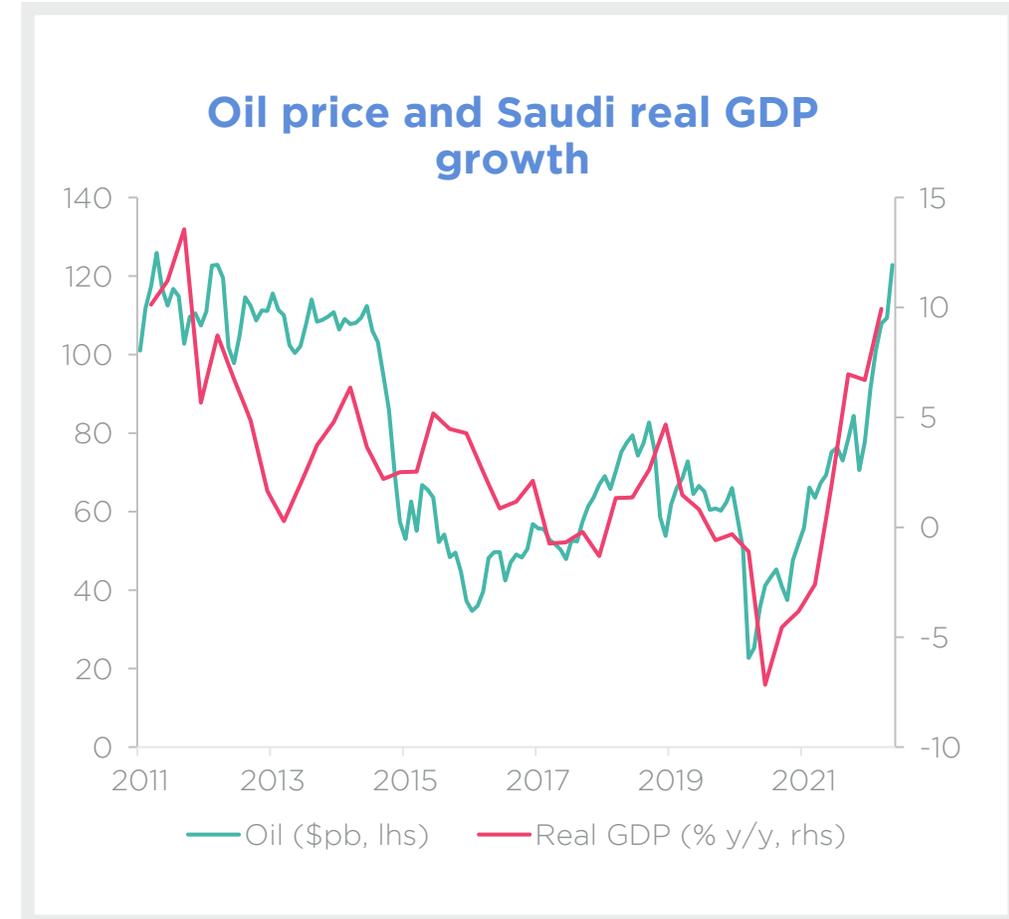
## Africa – A stark contrast between winners and losers

- High commodity prices, particularly coal and iron ore, **benefit South Africa** (where corporate ESG is also much stronger – e.g Kumba and Amplats)
- However, **structural constraints** (including political corruption and lack of reforms) still **hamper long-term growth prospects**
- Mounting inflation pressures (currently 5.9%) have pushed the **SARB into a more aggressive hiking** cycle
- Other areas of Africa are **vulnerable** to food supply issues, and/or currency crises (e.g. Kenya)
- **Egypt**'s external vulnerabilities are a near term concern, but will ultimately be addressed by significant support from the Gulf and IMF



# Middle East – Not just a safe haven

- Saudi economy is growing at the **fastest pace in 10 years**, due to oil (Q1 9.9%)
- Fiscal stance has been tight, with a **surplus** of 7.1% of GDP in Q1 2022
  - But signs that purse strings could soon be loosened, supporting growth further
- **Demographics** are also amongst the most favourable in Emerging Markets (1.6% growth p.a, vs 1.0% for India)
- Scope to **boost tourism** significantly, targeting 100mn by 2030 (vs 20mn in 2019 and 38.9mn for the UAE)
- Very low household debt (~14% of GDP)
- We initially invested in Saudi Arabia in March 2021, which comprises the majority of our **7.7% in the region**



# Dar Al Arkan – A multi-year growth opportunity

**DAR  
AL ARKAN  
دار الأركان**

- **Leading Saudi developer**, in highly fragmented industry
- Beneficiary of Saudi’s **demographics and modernisation** resulting in long-term structural growth
- **Supportive government policies**; economic tailwinds (oil) are merely a further bonus
- **Site visits** to confirm ESG standards; 1/3 of senior management are female; **C rated**
- Delivered almost **40% share price return in 2022**, as investors ‘discover’ the company



# CHINA: HAVE WE REACHED THE TURNING POINT?



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# China – Economic stimulus has started

## Monetary

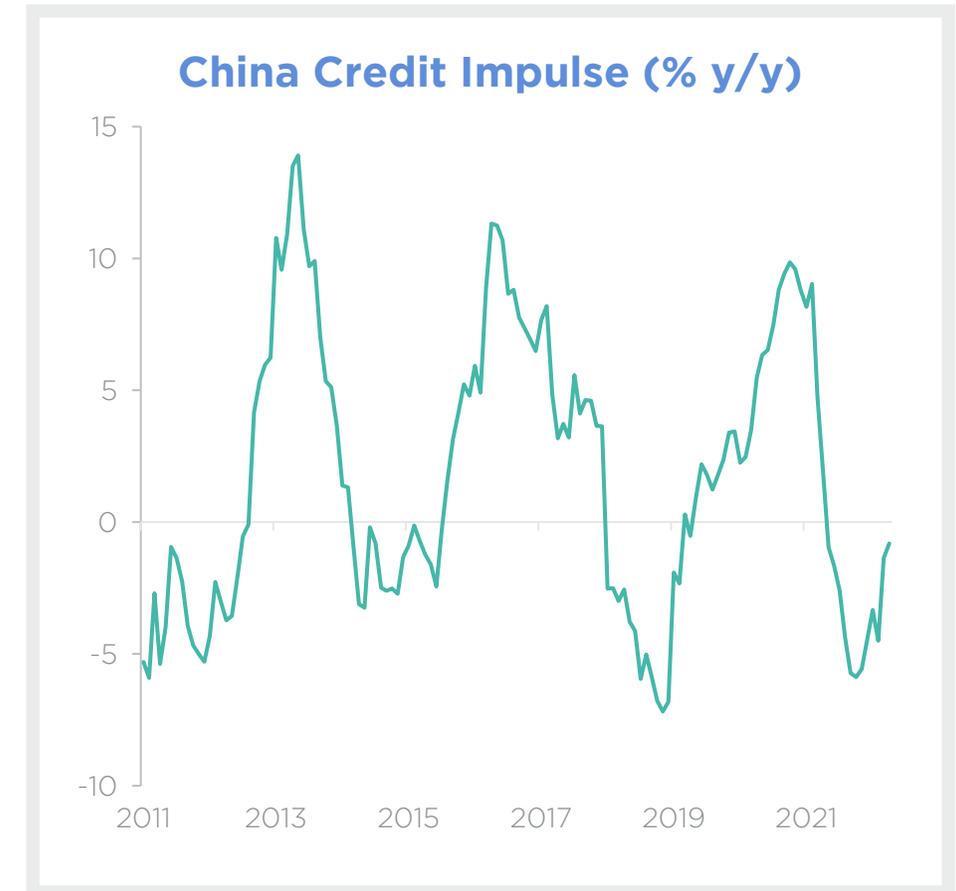
- **10bp interest rate cut** (Jan 22), 75bp bank reserve ratio cuts (Dec 21, April 22)
- **Doubled bank lending quota** for smaller companies; RMB 800bn quota for **infrastructure** investment

## Fiscal

- RMB **3.7tn of local government special bond issuance** (supporting infrastructure investment further) – with the first tranche completed by July and to be spent by September
- Budget included RMB 2.5tn **tax cuts/rebates** (including 60bn for auto purchase tax), RMB 1.6tn **profit transfer from financial institutions**

## Property

- **20bp cut** in 5-year prime rate (5bp and 15bp cuts – Jan & May 22)
- **20bp cut** in lower bound of mortgage rate **for first-time homebuyers**



# Politics in China

- The commitment to **zero-covid weighed significantly on Q2 GDP growth**
  - But policies have now been tweaked to reduce disruption
- 20th Party Congress due this **Autumn**, with President Xi hoping for a 3<sup>rd</sup> term
  - Xi will want a stronger economy and healthier labour market in coming months
  - Crackdown on Tech sector also eased
- Could **Premier Li Keqiang** be appointed President instead? Not our base case, but
  - Recent higher profile (conference call with 100,000 local administrators, pushing for growth)
  - May be more willing to abandon zero-covid and more market/economy friendly
  - Prospect for better US relations?
  - Taiwan invasion less likely?

Regardless, the bad news is well known, and reflected in valuations



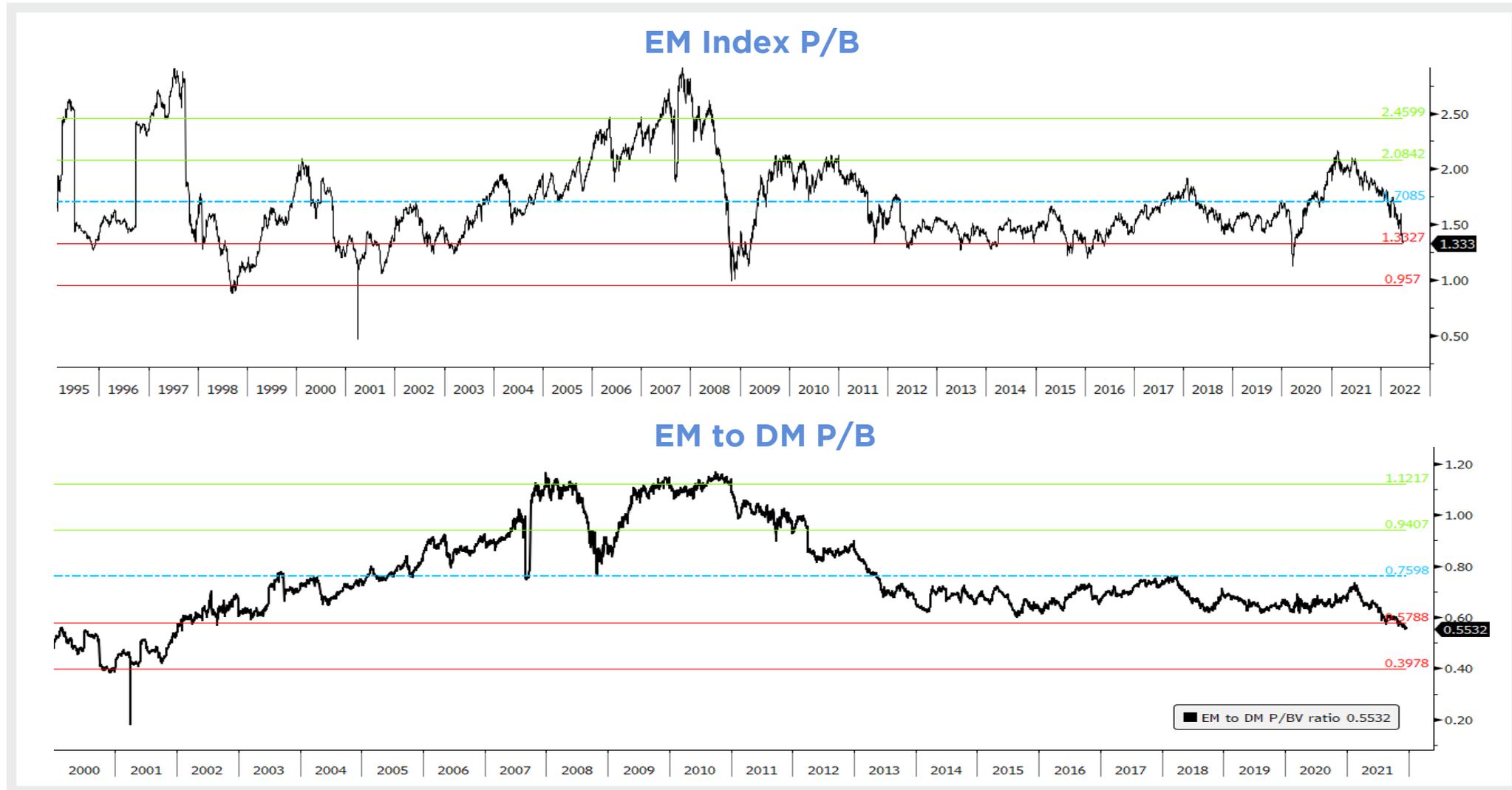
## Our focus is on the upcoming domestic upswing

- We are **overweight** China vs indices
- But we do not compromise on ESG, with a **40% fail rate in our filter**
- 16 of our 19 holdings\* are driven by **domestic Chinese growth**.
- Key holdings include **Tencent** (B rated), **Yongda Auto** (C rated) and **Hangzhou Robam** (C rated)

**ROBAM老板**



# Which will catalyse the entire over-sold and unloved asset class





INDIA: GOOD, BUT...

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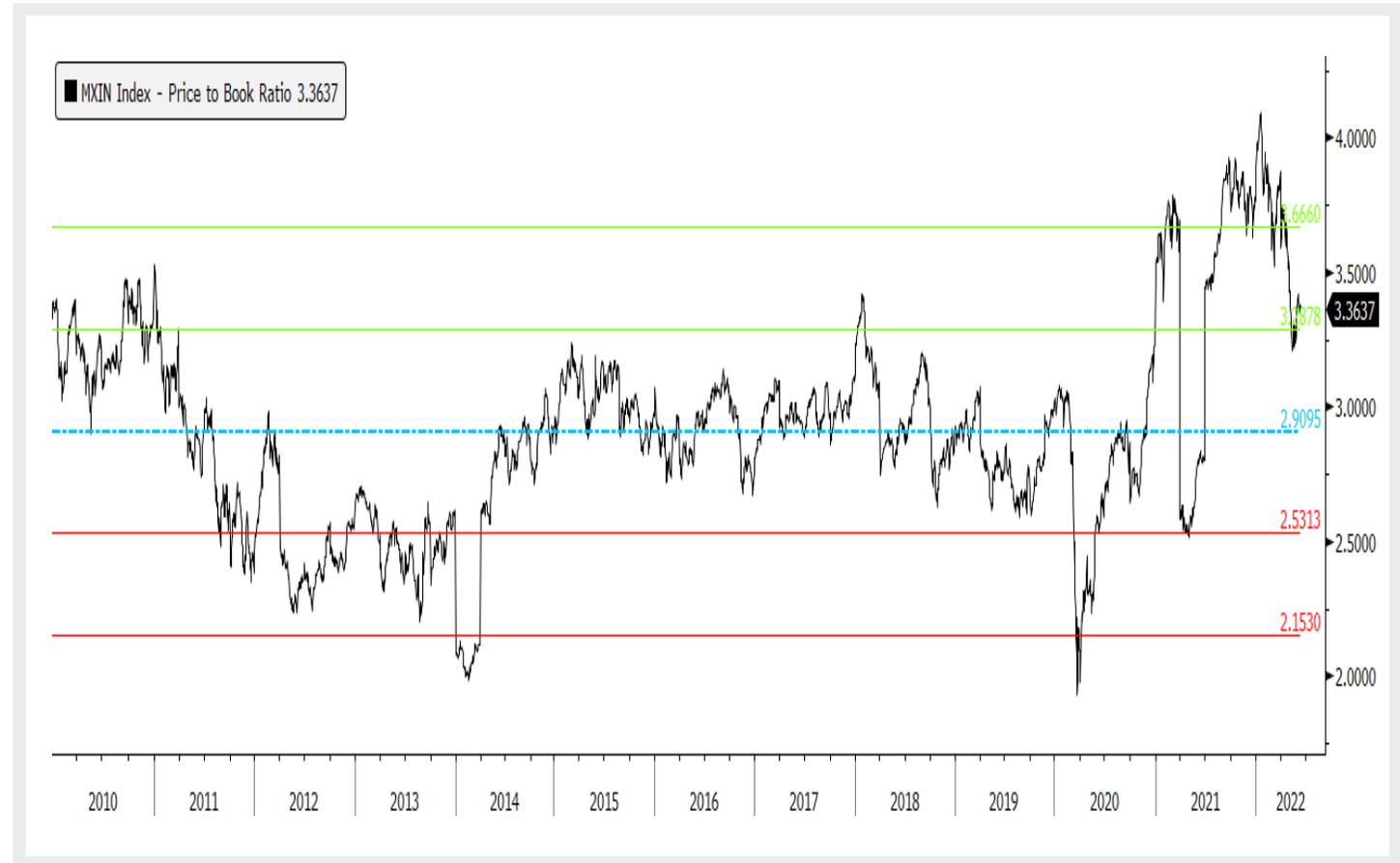
## The long-term structural story continues

- **GDP growth to remain robust** (7.5% for this year), aided by favourable structural factors and supportive fiscal stance
- Exports are on a structural uptrend
- **Stable politics** after state election wins for ruling BJP allows for policy continuity. Next national election not scheduled until May 2024
- **“Normal” monsoon still forecasted**, which would be positive for inflation dynamics and the rural sector
- Our **Transforming Lives Consumer Panel** continues to reveal stress for certain groups

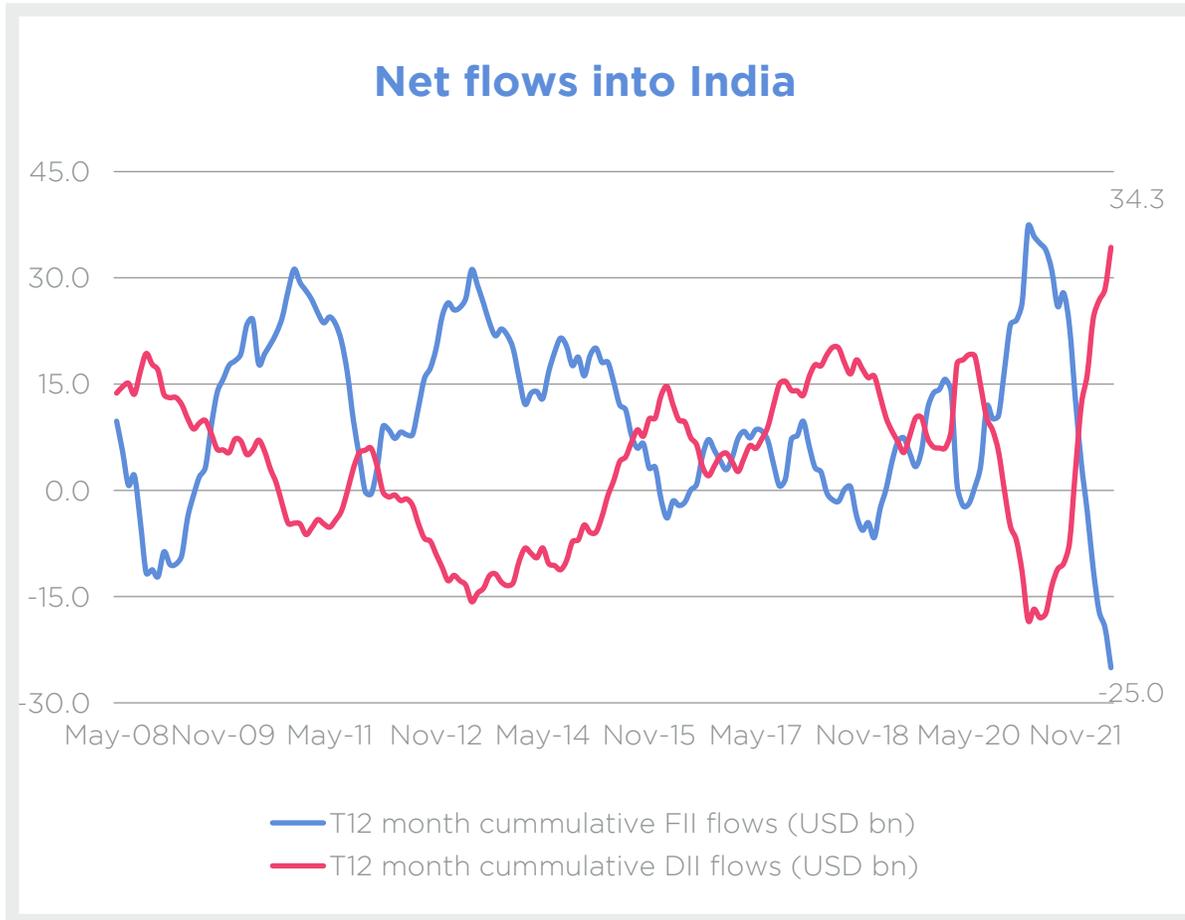


## But there are risks

- **High oil price has added to inflation** (7.0% y/y in May; 6.75% average forecast for FY23)
  - This will weigh on consumption and lift the current account deficit to 3% of GDP
  - We expect interest rates to rise from 4.9% currently to 6-6.25% by year end
- **Valuations have corrected**, and a premium to history is justified given structural improvements



# Our positioning



- Foreigners have been consistently reducing their exposure; we also moved **underweight last year**
- We **have reduced small cap in favour of large cap** across all funds, where we see greater value – especially in the banking sector
- Stock specific opportunities abound however – e.g. **Lemon Tree Hotels** (B rated)

A photograph showing two individuals wearing traditional conical hats, sitting amidst a vast field of green fishing nets. The scene is captured from a high angle, with the nets creating a complex, textured pattern of folds and ripples. A semi-transparent white banner is overlaid across the middle of the image, containing the main title text.

# SMALLER MARKETS: UNFAIRLY IGNORED

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# A key differentiator for Alquity



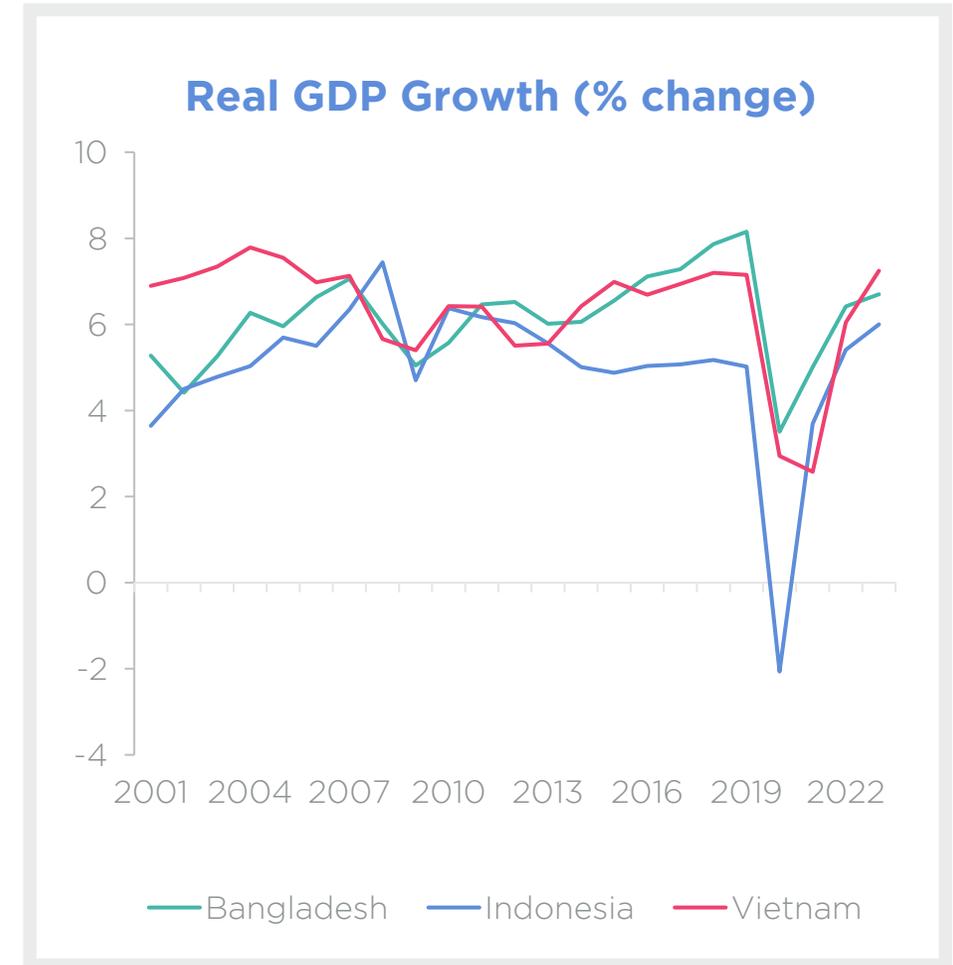
**Indonesia:** Economic recovery supported by high commodity prices and on-going reforms. Inflation well contained at 3.6% y/y in May



**Bangladesh:** Benefits from powerful long-term structural forces, including favourable demographics (population of 166M; with 56% under age of 30) and rapid urbanisation



**Vietnam:** Has emerged as a key manufacturing base in the Asian region, supported by robust FDI flows (~4.5% of GDP).



# PERFORMANCE: OUR STORM SURVIVAL STRATEGY



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# Performance

- All 3 funds are positioned in second quartile over year to date as **our quantitative risk process has delivered in difficult market conditions\***
- **Alquity Asia is positioned in the top quartile** over 1 and 2 years\* and has outperformed in 7 of the last 8 quarters\*\*
- **Alquity India is positioned in top quartile** over 1 and 2 years and since inception; second quartile over 3 years\*
- Top 3 stock contributors in 2022\*: Pacific Basin Shipping, Kino, Lemon Tree Hotels
- **Performance is multi-dimensional**, we provide lower GHG and water intensity in our portfolios vs index



# Strategy

- **Focused portfolios:** 62 positions in Future World, 56 positions in Asia
- **Risk controlled allocation to smaller stocks** (currently around 25% active weight).  
Examples include:



Pakistan,  
Electronics



Mitra Adiperkasa

Indonesia,  
Retail

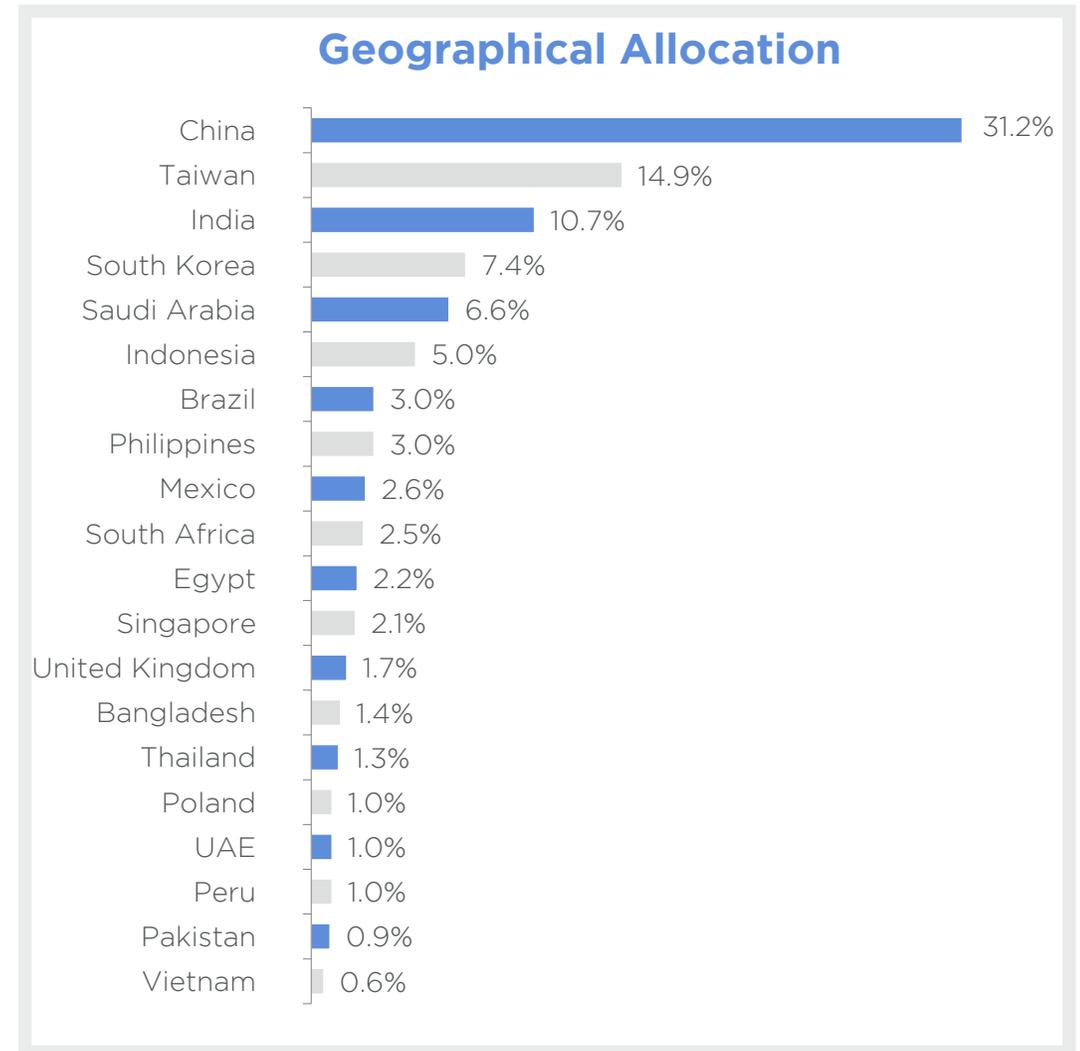


Bangladesh,  
Home Appliances



NAM LONG

Vietnam,  
Real Estate



# CONCLUSION



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# Conclusion

## — Entering a **positive environment for Emerging Markets**

- Experienced team has weathered the storm
- Valuations are compelling

## — **Differentiated portfolio**

- Smaller markets and stocks ; early entrant into Saudi Arabia

## — **Differentiated business model**

- Certified, fully integrated ESG process
- Convergence of **ESG and Impact** - and we deliver on both



Q&A



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