Thoughts from our Frontier Markets Team

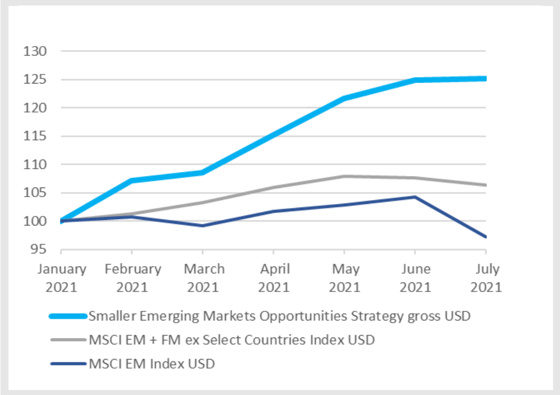
Smaller Emerging Markets: a Wealth of Opportunities

– August 2021

The Smaller Emerging Markets Strategy ("SEMS") was launched on 6th January 2021 with a mandate to generate alpha from investing in emerging and frontier market equities globally, outside of the largest seven emerging markets as defined by MSCI. The Strategy was seeded with capital from the Co-Portfolio Managers and investors, aligning everyone's interests in its future success.

In the first seven months of performance the Strategy has started to capitalise on the alpha opportunity presented by a set of circumstances that is likely to remain in place for some time and become even more conducive to the Strategy and investment process.

The chart below puts performance since launch in the context of the MSCI Emerging Markets Index and the Strategy's Custom Benchmark (all emerging plus frontier markets minus the largest seven emerging markets).



Source: Fiera Capital, data as at 30 July 2021

Why SEMS? Why now?

To recap on the reasons for launching the Strategy and the timing of the launch, **we have seen and continue to see a significantly shifting emerging market equity investment landscape which is presenting more and more opportunities for active, benchmark agnostic investing.**

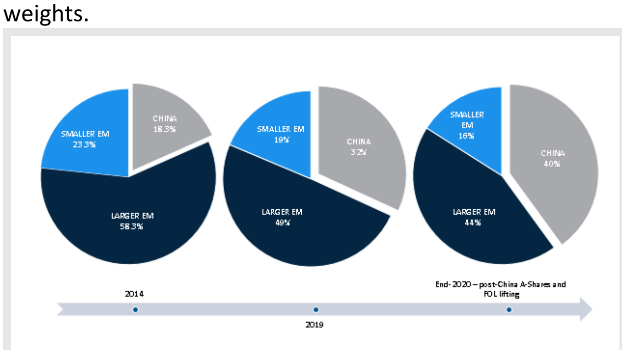
The last 10 years have seen some significant changes to the emerging market investment landscape, both in terms of the shifting geographical bias and the types of investors that make up the shareholder bases of many emerging market companies.

The **first paradigm shift** which has affected the equity universe globally **has been the move by international investors into passively managed funds.** In the year 2000, passive holdings accounted for just 1% of the foreign money in emerging markets (this is for publicly available funds). This rose to around 10% by 2006 and almost 37% today, worth over USD 800B.[1] The size and weight of passive money is crucial to the evolution of emerging market indices as this money is obliged to automatically follow any changes or reorganisations. **This presents a wealth of opportunities for active, benchmark agnostic investors.** Avoiding the losers is as important as finding tomorrow's winners – especially so in the smaller emerging market universe.

Secondly, the shape of the emerging market indices has altered dramatically over the last few years in terms of regional weightings and **there have been some very large changes in country weights.** These changes have been driven by both increases in free float factors or Index inclusions for some countries, and by relative performance of economies and stock markets.

[1] Rencap, as at 29 Jan 2021

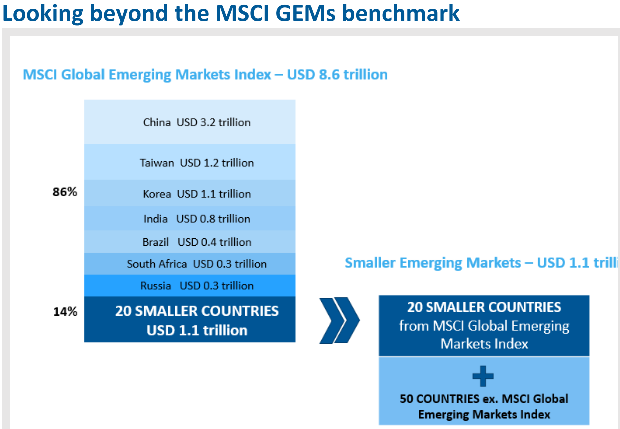
For example, in 2019 the MSCI increased the inclusion ratio of China A shares from 5% to 20% in the MSCI Emerging Markets Index. These changes over time have resulted in the correlation of China with the MSCI Emerging Markets Index going from around 0.65 in 2003 to 0.9 today, and likely to trend further towards 1 as the China weight continues to increase. Effectively, this means that China is likely to move in virtual lockstep with emerging market indices. China's increasing dominance in the Index means that investors are gaining negligible diversification benefits, even by investing actively in funds with outsized China weights.



Source: Fiera Capital, MSCI Database, 30 Jun 2021

Today's emerging market universe has become dominated by a small number of large markets, with the largest 7 countries accounting for more than 86% of the MSCI Emerging Markets Index.

Looking beyond the MSCI GEMs benchmark



Source: Fiera Capital and Bloomberg, 30 Jun 2021 (Investible Market Capitalization of Shares in Index). All numbers presented in US dollars

Specialist global emerging market investors need to focus on these largest seven markets in order to have a chance of generating relative performance. This is inevitably leading to a reduction in focus on the other 20 markets that make up just 14% of the MSCI Emerging Markets Index. MIFID II pressures have multiplied this effect by reducing the focus on companies in these markets from the global investment banks representing the sell-side. **This exacerbates the inefficiencies in stock prices across these smaller markets.**

The alpha generating potential from inefficient stock pricing in frontier markets has been well demonstrated by our investment team over the last 10 years. Over the last few years, many of these 20 smaller emerging markets have begun to exhibit similar characteristics, namely markets and stocks that are "under researched and under owned."

The newly launched Smaller Emerging Markets Strategy looks beyond these 7 major markets to the smaller countries in the MSCI Emerging Markets universe, as well as all frontier markets where we believe, **due to the factors above, a big alpha generating opportunity continues to exist and is steadily growing. We pursue a very active Strategy, with a strong focus on bottom up investing and top down analysis providing a negative country screen. The Strategy is benchmark agnostic with a focus on domestic growth opportunities in economies that are growing strongly due to reform processes enacted by the local administrations.**

Where are we different?

Country	Portfolio Ending Weight	Benchmark Ending Weight	Difference
Thailand	1.34	10.47	**-9.13**
Mexico	4.12	12.5	**-8.38**
Saudi Arabia	12.49	20.19	**-7.70**
Malaysia	0.91	8.29	**-7.37**
Kazakhstan	5.66	0.53	**+5.13**
Greece	10.26	1.16	**+9.10**
Vietnam	17.31	2.14	**+15.17**

Source: Fiera Capital, MSCI, 16 Aug 2021

Greece – a case study

Market Background

When the current co-Portfolio Managers started their careers in emerging markets in the early 1990's, Greece was classified as an emerging market. Following the introduction of the Euro, Greece was reclassified to developed market status in 2001, albeit with an economy that was really only supported by the subsidies that it received as part of its Euro membership, both direct and through cheaper borrowing costs. Following another debt induced financial crisis in 2012, Greece was once more downgraded to emerging market status in 2013, but due to the years of austerity as a supposed recovery mechanism, floundered outside of the mainstream emerging market world as both international investors and international investment banks deserted it.

The Trigger for Change

In late 2019 a co-ordinated plan was put in place to begin to recapitalise the Greek banking system which was subsequently overtaken by the beginning of the COVID-19 crisis in 2019. However, despite a very weak Greek economy in 2020 due to its heavy reliance on the tourism sector, the Greek banks were substantially aided by the implementation of the European Recovery Fund, of which Greece was the largest relative beneficiary. The Greek banking recapitalisation continued unabated, and in fact aided it might be argued, by the COVID-19 crisis.

In November 2020, when the team made its first investments in the Greek equity market for many years, Greece was just 12 basis points of the MSCI Emerging Markets Index. Foreign investors and global investment banks were scarce, but we identified a clear inflection point in the Greek economy and begun to invest. Positions were implemented in this Strategy on its launch.

Examples of companies we have invested in: (positions have been sold, added to or reduced over the course of the year):

The first investment for this Strategy was **National Bank of Greece** where recent fundamental changes have largely been ignored by the market. Securitisations in Q2 or Q3 this year will bring NPL's (Non-performing loans) down to single digits (including collateral) for the first time since the global financial crisis. 50% of the balance sheet is now, due to ECB policies, yielding a positive 100 basis points carry (the bank effectively gets paid for expanding its balance sheet) making it possible, through expanded net interest margins and therefore profitability, to produce a clean balance sheet by the end of this year. Looking two years forward, the bank should be producing an ROE of around 9% and was trading at just 0.35x price/book. With a cost of equity of around 6%, it is not a stretch to suggest a price/book of 1x is attainable.

OPAP, the Greek gaming company, is another situation that we believe has been largely missed by the market. Recent advantageous tax changes for the company have been largely ignored as the pandemic has hogged the news headlines. However, on a country and a stock level, this is one of the most exciting opening up trades that we find anywhere in our universe. On a normalised basis, the stock trades at a free cash flow yield of 16%, versus historic levels of below 8%.[2] The company has traditionally paid out its free cash in dividends and with Greek 10-year bonds trading at a yield of about 70 basis points, the re-rating potential is huge.

Where are we now?

The Greek banking system has continued to recapitalise successfully and with greater than 5% GDP growth expected this year is set to be able to take advantage of growth opportunities. Greece is now 18 basis points of the Emerging Market Index, a 50% relative rise on 9 months ago, but continues to be largely overlooked by global emerging market funds.[3] This Strategy now has a 10.3% position in Greece and we continue to see significant opportunities to invest.

[2] Fiera Capital, as at 30 July 2021

[3] Factset, as at 30 July 2021

Summary

Less well researched and less well owned smaller emerging markets have normally appeared in this category for a reason; there have been political or economic events in recent history that have not been conducive to capitalism and therefore economies and stock markets are less well developed than they otherwise would have been.

The investment team have a long track record of focussing on countries that are going through positive reform processes (and also avoiding negative ones) and selecting stocks that can benefit. The stock selection process is driven by financial modelling and a strict adherence to valuation criteria. We do not invest on a top down basis, positive top down dynamics will determine the focus of our bottom up efforts.

The team's 11 year track record in frontier markets

Annualized Returns	Frontier Markets Strategy	MSCI Frontier Markets Index
3 Years	13.5%	8.9%
5 Years	15.6%	9.4%
7 Years	10.5%	2.4%
10 Years	10.0%	5.3%
Since inception*	12.0%	6.3%

Source: Fiera Capital, MSCI as at 30 June 2021. Frontier Markets Strategy returns are based on composite returns on all share classes. All figures are based on gross, USD returns. *The Frontier Markets Strategy inception date was 30 Jun 2010

At the moment it seems inevitable that the circumstances that brought about this Strategy will continue to expand the opportunity set and that we are at the beginning of one of the largest Alpha opportunities in our emerging markets careers.

Examining the broad emerging market equity investable universe, it is clear that many countries, that in some cases make up a substantial part of the MSCI Emerging Market Index, are experiencing significant challenges and potential risks at the current time. From the significant regulatory changes in China that have been destroying capital for the past few weeks, to Taiwanese geo-political risks, Brazilian political instability, Indian healthcare concerns, Russian sanctions escalation prospects and South African economic deterioration, there are certainly a collection of potential headwinds that might over-ride positive fundamental opportunities.

This Smaller Emerging Markets Strategy allows investors a very differentiated approach and opportunity set in emerging markets by focussing on the many positive reform stories in the less well researched and less well owned emerging and larger frontier markets where we find very positive domestic dynamics supporting the growth of well-run companies. A very benchmark agnostic approach to investing allows us to focus on the impacts of positive reforms with examples including the positive economic outcomes of the Omnibus Law in Indonesia, the continuing significant economic reforms and results in Vietnam, the recapitalisation of the Greek banking sector and the continued reforms in the Middle East driving opportunities in Insurance in Qatar, real Estate in UAE and mortgage growth in Saudi, to name a few.

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