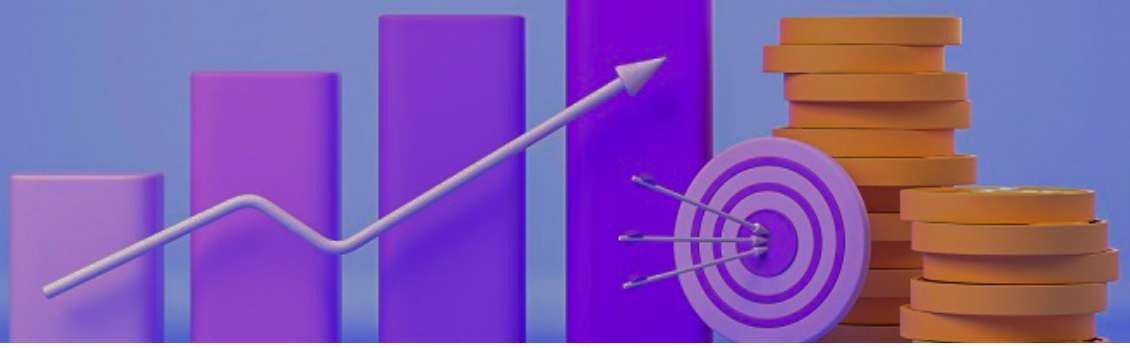
Equity Investment Opportunities in the Emerging Markets: Could 2023 onwards be 2003-2008 all over again?

Following over a decade of poor performance relative to the Developed Markets (DM) arena, experts at GAM Investments believe the opportunity set within Emerging Market (EM) equities has not been as strong for many years, and that a confluence of positive factors could presage a similar, and possible even better, EM bull market run as enjoyed by investors between 2003 and 2008.

Hubbis invited private bank gatekeepers, asset managers and CIOs based in Asia to a behind-closed-doors discussion, covering these key topics and more besides.



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INTRODUCTORY WORDS FROM PHILIP ROSENBERG:

"It could be the dawn of a new era, and today we can wonder if the splendid five-year bull market in EM equities from 2003 to 2008 can potentially repeat itself, and soon. And that is what Tim Love is going to offer you our views on today, whilst also hearing how you experts in the wealth industry in Asia perceive the situation and the future.

GAM Investments is an investment management firm, we are going to celebrate our 40th year next year. We manage approximately USD 84 billion. We're very active in the long only space, both in equities and fixed income and alternatives and multi-assets, and we employ approaching 600 people globally.

I am responsible for our business in the Middle East, which today is primarily institutional, and we're looking to develop and grow that in the multifamily office and the single-family office space.

In terms of our approach, we like to partner with our clients, and one of the things that I have discovered over the last few years since I've been responsible for this part of the world is that the family office community over here is extremely sophisticated, with great professionalism amongst the CIOs and the portfolio managers and the investment specialists. The family offices now take an increasingly institutional approach, which marries very well with our approach and our offering.

Let me briefly introduce Tim, who is London based and runs the GAM emerging equity business, overseeing investments of around US1 billion, with a fantastic team of five people based in Hong Kong and in London."

TIM LOVE
GAM Investments

As exclusive partner for the event, GAM Investments was represented by Tim Love, Investment Director & Head of Emerging Equities, as well as Philip Rosenberg, Managing Director, Head of Distribution for the Middle East.

Tim is responsible for the Emerging Markets Equity strategies. Before joining GAM Investments in February 2012, he was a senior portfolio manager at CQS/ Oceanwood, managing long/short emerging markets equities. Before that, he worked for a global long/ short equity fund at Cazenove Capital Management.

Tim has also held sell-side positions as head of global equity strategy at Deutsche Bank, director of the process for global emerging markets at SG Securities, and head of emerging markets strategy and research at ING Baring Securities. Before that, he managed emerging markets equities portfolios at BlackRock (formerly Merrill Lynch Investment Managers) and at HSBC Asset Management.

He holds a BA in Accountancy and Politics and trained as a chartered accountant at PricewaterhouseCoopers. He is based in London.

Philip Rosenberg is Managing Director and Head of Distribution for the Middle East. He looks after regional institutional, private wealth, and wholesale relationships. Philip has been involved with asset management distribution for over 33 years, including fixed income, equities, and alternatives.

He joined GAM Investments in 2010 and has been closely connected to the firm since 1998. Before joining GAM, Phil was an Executive Director at Julius Baer in the Middle East team. He also worked at EFG Bank, advising clients in the US, Middle East, and the UK. Before this, he held senior distribution and marketing roles at Liberty Ermitage and Credit Lyonnais. He is also based in London.

A Snapshot of the Presentation from Tim Love:

Armed with a comprehensive and insightful slide presentation of 68 pages, Tim offered invitees his vision of the world of EM equities. For the purposes of this summary, Hubbis has, in brief, selected some of his key observations.

The EM equity waters are vast and incredibly diverse. GAM breaks them down into manageable elements by combining top-down analysis with bottom-up research to help drive alpha from multiple diversified sources.

GAM's EM equities team seeks to deliver superior long-term outperformance through investing in a diversified portfolio of long only emerging market equities, holding on average some 140 plus stocks. The team believes that EM equities offer opportunities from frequent valuation mispricing due to regulatory, political, geopolitical, credit and structural change as they grow and mature.

And the team maintains that there is a confluence of factors currently massing to create a wave of demand for EM equity that could result in a bull market run similar to, or better than, the great 2003-2008 surge in valuations.

Selecting out sustainable growth and quality stocks from the rising world of EM equity

"We believe the best way to generate alpha in EM equities is via our combination of top-down and bottom-up analysis, with ESG considerations explicitly embedded within the investment process," Tim reported. "We are style-agnostic, with the flexibility and experience to capture alpha in different market phases."

He explained that the world of EM equities is huge and daunting. He explained that in terms of rewards ahead, there are secular and cyclical drivers with EM potentially offering more sustainable growth and a superior risk-return profile versus developed markets.

He said that after a major and sustained drawdown in EM equity prices, there is also significant re-rating potential, with nearly all of the top ten EM countries now rated investment grade and emerging markets now viewed as a far 'safer' investment than a decade previously.

Active is the right approach to EM equity

Tim explained the EM equities offer broad appeal – EM valuations

are at very attractive levels versus historical levels and compared to developed markets, and EM equities offer a remarkably diverse set of opportunities for value, for growth and for income.

Tim believes that as to alpha generation, EM equities typically have more valuation disruptions than other asset classes, hence an active approach using strong fundamental tools can enhance risk-adjusted returns.

Emerging Markets are no longer dominated by old world companies; they offer new world stocks aplenty

Tim explained that the world of EM equity offers an incredible array of fascinating, new world and new economy stocks, many of which undervalued and high quality. EM equity is no longer dominated by traditional industries; headlined by major corporations from China, Taiwan, Korea and elsewhere in Asia in particular, EM equity offer great opportunities to participate in technology, green energy, EVs, healthcare innovations, climate change and other key areas of tomorrow's world.

He acknowledged that performance in the last five or six quarters had been challenging to say the least – the longest EM equities drawdown and one of the deepest in magnitude - but said he believes that the EM market will turn and that there is lots of alpha to come.

Be brave and seize the day – a virtuous circle of performance is soon to begin

"We are already at a historical low, even as low as during the worst of the global financial crisis, but today we see a far stronger set of companies, and a much more resilient earnings flow," he told guests, adding that the quality of EM had risen substantially over the years, with ESG having also driven up governance and accountability and having helped reduce many EM-associated risks.

He noted that FDI and other flows driven by more diversified global access into the EM arena had also helped improve governance, boosting liquidity at the same time.

After the perfect storm, the perfect wave might be building

All in all, he concluded that EM is under owned, under loved, and undervalued, even the currencies. "This is the perfect time to be investing in EM equity," he stated. "It really doesn't get better, especially when the perception is so far behind the reality of the quality of what you can invest in. I remember the Asian Financial Crisis of 1997 onwards and the subsequent seven years in the wilderness. But when Asian markets turned, the years from 2003 to 2008 were truly incredible in terms of performance, liquidity and momentum."

He said that 2003 EM equities recovery started from a roughly 10x PER and grew to a massive wave that propelled valuations to about 24x, with an annual earnings growth of over 20%.

Actually, this time round, he indicated the surge could be even more dynamic. "So, the question is, what is the catalyst that will turn these markets upwards?" he pondered. "Well, it actually comes down to the dollar, and the REER – real effective exchange rate – which is at a 20-year high. If investors can get 3% for doing nothing in dollars, they might feel they can just sit on the side-lines and wait."

However, he thinks that is the wrong approach. "If I am right, the dollar is about to peak within the next six months," he said. That will help trigger a major change in perception of EM equities and result in time in a re-rating of EM, with the MSCI EM PE rising from slightly below 10 times currently to 18x or more, supported by plus 25% earnings growth and every liquidity argument you can think of, creating a virtuous circle incredible quickly.

Don't wait – the time is ripe to re-enter the EM equity markets

Tim explained that with the high quality and diversity of stocks, countries, and regions, and their strong financials, and with China now at some30% of the MSCI EM index, the arrival of dollar peaking and later retrenching, will help turbocharge EM equity performance.

He indicated that their selected EM equity arena could then surge upwards within the coming six months. He did however offer the caveat that not all EM is currently in the mire. He said India's equity market surge in the past two years had left it overvalued in his view, while China, he said, is "cheap as chips", at least in 'A' share format.

His major caveat in terms of risks ahead related to Taiwan. "That is really the wild card" he said, implying that if there is geopolitical and military aggression towards Taiwan from any quarter, it is effectively game over.

In conclusion, GAM's EM team has the following key observations:

There are currently multiple secular drivers that continue to propel both EM economic growth and the local demand curve.

Earnings are enjoying a significant Post-Covid recovery, both in magnitude and quality, enabling a rebound in EPS that is as yet underappreciated by the market.

There is a broader and more diversified EPS recovery than in previous market phases.

Cash generation is stronger than before, enhancing investment returns.

Moreover, many key EM currencies are offering real returns and currently undervalued, especially against the greenback.

And as to valuations, Tim and team believe EM equities are currently attractively valued relative to history and comparable asset classes.

Accordingly, they believe markets are still materially under-allocated to EM equities versus index weightings, partly, he argued, in response to excessive worries over China's surprise regulatory and other actions in 2021, which spooked international investors.

During what was a fascinating and remarkably lively talk, Tim drilled down into a lot more detail, before signing off by advising guests to review the 68-page GAM presentation, which can be found HERE. ■