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Frontier Markets and The Continuing Expansion of the MENA Proposition

The China Club in Hong Kong was the venue for a discussion led by Hubbis and our co-host, Fiera Capital, to deliberate on the current state of frontier markets such as Vietnam, Saudi Arabia and others in MENA. The guests heard how frontier markets can provide both high growth and low correlation to global equity markets, while the macro stands out. It is possible to generate high alpha sustainably by following certain key disciplines for frontier market investing, especially keeping a close eye on political and regulatory reforms. Attendees also learned more about Fiera's emerging market dividend strategy, which focuses on growth stocks that offer rising dividend flows.

The key takeaways

No super-cycle anticipated

Fiera's team of experts do not foresee any super-cycle of global economic or commodity growth that will drive equity markets, particularly emerging markets, for the foreseeable future.

Domestic growth story to prevail

Instead, the story of domestic growth and consumption will drive EM and frontier markets and produce pockets of growth in countries, regions and sectors which create the investment opportunity.

Frontier's low correlation

Frontier markets have a very low correlation to emerging or developed markets. They are mainly driven by domestic reforms rather than by global economic factors.

Reform is crucial

Fiera's investment teams seek out frontier countries that are going through robust reform processes, much as leading EM countries have done over the past few decades. Positive political, economic and financial markets reform processes taking place create economic growth and result in waves of equity market investment opportunities.

But... watch out for surprises

The experienced market watchers also know how political change can cancel out reform processes. Look at the cautionary tale of Venezuela for example.

Middle Eastern appeals

In the Middle East, Saudi Arabia is probably the standout country right now where real reforms are actually happening, following reform processes initiated in Kuwait, Dubai, and some of the other countries in the MENA region.

Vietnam beckons

While Chinese exports to the US are down 12% year on year, Vietnamese exports to the US are up 12% year on year. But Vietnam's appeal goes far beyond its exports and FDI stories, as the country is enjoying rapid reform and fast-rising domestic consumption. The Vietnamese economy is now growing at 7% a year, with 7.3% registered in the third quarter of 2019.

Valuations in Vietnam are not so daunting

After removing the top four or five stocks by market capitalisation, which are bloated in valuation due to fewer restrictions on foreign ownership, the remaining valuations for the broader market are very appealing. Many selected companies below the roughly USD5 billion capitalisation range offer excellent value, according to Fiera's experts.

And EM status awaits

The icing on the cake for Vietnam is the well-anticipated upgrading from MSCI to emerging market status. Nobody knows when it will take place, but when it does, it will re-rate the market significantly.

China and India - as growth slows, consumption grows

In the EM space, GDP growth in India and China is slowing, but still strongly positive. But growth is not the key metric, domestic consumption is rising fast and spending on a whole host of areas, from consumer items, to mortgages to healthcare and insurance is growing apace.

Actively seeking value

Fiera's team explained their approach to active investing. The bottom-up approach is very hands-on, especially for frontier markets, and the firm is benchmark agnostic, seeks value, growth, governance and competition strength, and does not hold on to stocks once they hit targets. About 75% of these companies they research do not reach the governance standards the firm expects, so that combined with valuation metrics narrows the universe significantly.

EM strategy pays dividends

Fiera's representatives also highlighted their firm's emerging market dividend strategy, which concentrates on growth companies with low debt that also pay out high and/or rapidly rising dividends, with the portfolio offering a current yield of about 5.1%.

THIRTEEN IS LUCKY FOR SOME, AND THAT IS THE NUMBER OF WEALTH MANAGEMENT GATEKEEPERS and other experts who assembled for the discussion. Fiera Capital (FCC) was represented by a trio of emerging markets (EM) and frontier market authorities in the form of Dominic Bokor-Ingram, Lead Portfolio Manager, Vincent Duhamel, Global President & Chief Operating Officer and Stephen King, Head of Institutional Sales APAC.

Duhamel opened the proceedings, highlighting some key information about Fiera and also about the spring 2018 acquisition of Clearwater Capital Partners, experts in alternative credit in the Asian space [see Fiera Capital Overview below].

Bokor-Ingram then took the floor, opening with a comment that from a big-picture viewpoint, the EM space has had plenty of vigorous ups as well as precipitous falls over the past three decades during which he has built his own expertise.

No super-cycle anticipated

"Today," he reported, "we do not foresee another super-cycle in economic growth or commodity growth that will drive equity markets, particularly emerging markets, for the foreseeable future. Instead, what will drive emerging markets is more the story of domestic growth and consumption, and our mission is to find those pockets of domestic growth amongst the EM and frontier market spaces."

He also highlighted how frontier markets as an asset class has a very low correlation to emerging or developed markets.

"Frontier markets tend to be driven much more by what's going on domestically than by what's going on in global markets," he explained. "And correlations between frontier markets also tend to be very low. For example, the Pakistan index over the last year is down significantly in US dollars but that has zero impact on Saudi Arabia where you have a very positive reform process, you have an MSCI upgrade cycle and the market in the last year there is up sharply in US dollars."

He turned the spotlight on Fiera's Magna New Frontiers Strategy, which sits under Fiera Capital (Europe), the latter a specialist equity asset manager with AUM of USD2.8 billion and which itself is a subsidiary of Fiera Capital Corporation (FCC).

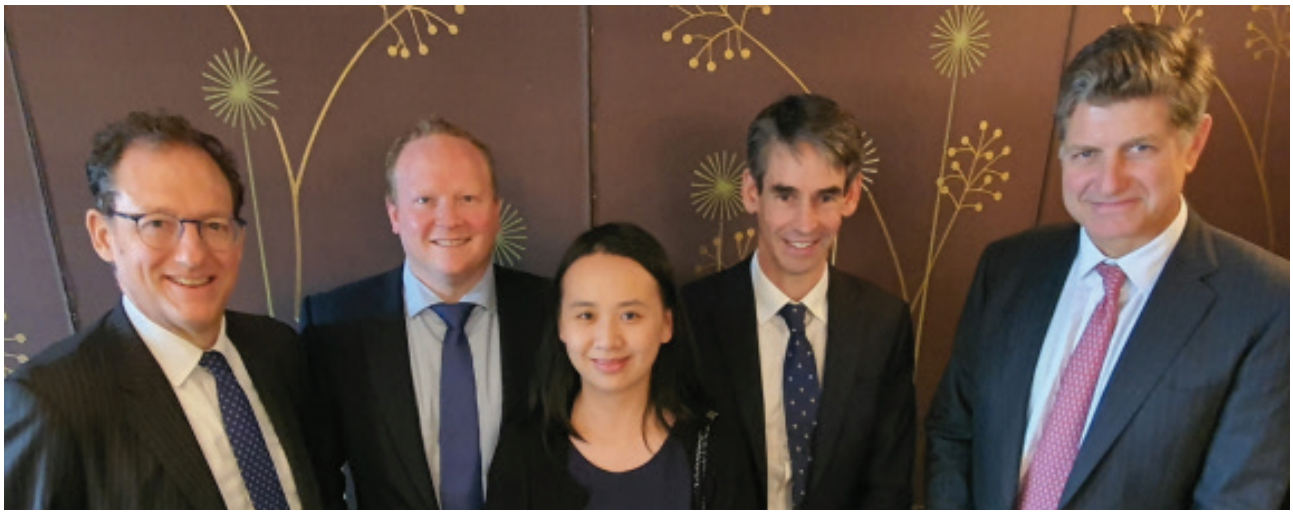
Extracting value from reform

"With our frontier markets strategy," he reported, "we are looking for countries that are going through healthy reform processes. We then run both the long strategy and a long-short strategy to take advantage on the short side of negative returns from the opposite of reform processes."

He pointed to Asia, where he observed that in the past 30 plus years huge reforms have taken place, and which have led to multi-year economic growth opportunities. "Emerging markets, as we know," he reported, "are about growth, so finding the right companies that can participate in that growth is the key and that is our remit from start of the investment process to the end."

In frontier markets, Fiera invests predominantly in countries that are going through positive reform processes. Why should that be and what does Bokor-Ingram mean by reform?

"In our long experience," he reported, "if you have positive political, economic and financial markets reform processes taking



place, there is virtually a one-to-one correlation with economic growth and those countries offer the best environments to find companies that can compound their earnings over many years, and that also offer the biggest re-rating opportunities."

Reform can also suddenly stop

One of the lessons that Bokor-Ingram and his colleagues have learned over the many years they have been involved in this sector is the understanding of how reform cycles play out, or sometimes how they fail to materialise or even reverse.

As an example of reform processes going in the opposite direction, he cited Venezuela. "New democracies and new reforms are not always sustainable and rely on the will of the politicians and the motivation of the people to sustain them," he reported. "Venezuela some 15 years ago was the wealthiest country in Latin America, had a constitution that looks very much like the US Constitution, but today is one of the biggest economic disasters in global history. And this in a country that has the largest oil reserves of any country in the world."

However, he stated that investment over the long term in those countries that are truly reforming will be in countries where the economic growth will be higher than global norms. "And as these markets are characterised by very low foreign ownership," he noted, "we are able to invest in stocks that are lowly valued, so we can play the economic, earnings and re-rating cycle. So, we have the twin drivers of corporate earnings growth from the reform process and a big re-rating from MSCI inclusion."

Less than two years ago, foreigners were not yet allowed to invest in the Saudi Arabian market directly, but by early June this year it was included in the MSCI Emerging Market Index, and Saudi Arabia today has 7% foreign ownership. But of course, that is far below names such as China and Brazil, with between 30% and 50% foreign ownership in their listed stocks.

Low correlation

As frontier markets offer high growth but low correlation to global equity markets, he highlighted the strong rationale for alpha strategies in these markets. He emphasised the sustainability of returns - despite the frontier status of markets such as Kuwait, Vietnam and the UAE, countries such as that which undergo and maintain serious reform programmes can achieve multi-year or even multi-decade growth. And he illuminated the key strategies and objectives of the Magna New Frontiers Strategy, which first launched in 2011 and today is 500m Euros in assets.

Moreover, they are not even correlated amongst themselves - so for example a currency devaluation of 80% in Egypt in 2017 had virtually no impact on other markets.

Experience counts

"Both I and my co-manager as managers of the strategy have a lot of experience," Bokor-Ingram explained, "with 30 years of involvement in Emerging Markets each. That type of experience is necessary when generating alpha in these types of markets, which are different even from most emerging markets."

He said in fact that he had been investing in frontier markets since

1992. "The Berlin Wall had come down in 1989, signalling the end of communism in Eastern Europe and equity markets started opening up with the very first equity market in the region being Hungary in 1992 moving on to Russia in 1993 and the rest of the region. Being of Hungarian parentage, that is where my interest began."

"Our personal interests are also aligned with our investors," he added, "as we also have a significant investment in the strategy ourselves. And we have produced very strong performance, with a positive three- and five-year track record of performance that is based on careful portfolio construction driven by extensive bottom-up analysis with a macro overlay, with absolute return as the first priority, as we pay no attention to benchmarks."

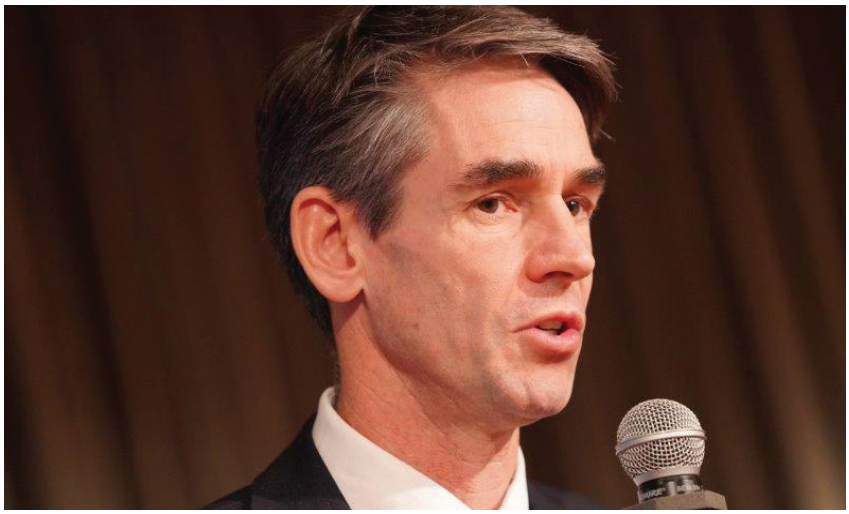
The Magna Frontier Strategy is heavily invested in a number of Middle Eastern countries where after many decades of not reforming, change is taking place.

Middle Eastern values

"Saudi Arabia is probably the standout country right now where real reforms are actually happening," Bokor-Ingram reported, but of course we still need to see if those reforms continue with a higher oil price. Kuwait, Dubai, and some of the other countries in the region such as Egypt and Morocco are also notable for their reforms."

But as with Venezuela there are the MENA countries that exhibit the opposite characteristics. "Nigeria has huge oil reserves," he noted, "but an economic and political system that is far from conducive to private enterprise or economic growth."

He expanded on MENA opportunities. For the Middle East, he said there is a massive perception gap in that region, and a core result is that it is the most under-owned EM region in the world, accounting for less than 6% of global EM, and with foreign ownership in Saudi Arabia at just 7%, Kuwait at 10%, the UAE and Qatar at 15%, those figures are far below the MSCI Global Emerging Markets levels of 30% to 50% foreign ownership.



DOMINIC BOKOR-INGRAM
Fiera Capital

Vietnam's many appeals

Talking about China's ongoing trade conflict with the US, Bokor-Ingram said Chinese exports to the US are down 12% year on year, while Vietnamese exports to the US are up 12% year on year.

"Vietnam is enjoying rapid FDI growth from the rest of Asia and particularly China, the latter largely to circumvent the trade restrictions," he observed. "Of course, Vietnam could be the next market under attack from the US, or we might have a trade deal tomorrow, no one knows, so actually we don't spend too long focusing on global macro views, unless they are of direct impact to our bottom-up model."

Looking around the globe, Bokor-Ingram sees Vietnam as the stand-out frontier market opportunity. "We see a very sustainable political reform process, and a sustainable economic reform process which is producing genuine growth in the economy and genuine growth in companies," he explained. "Meanwhile, for example, the number of state-owned enterprises over the last seven years there has gone from 1200 down to 100 as the private sector has blossomed. The Vietnamese economy is now growing at 7% a year, with 7.3% registered in the third quarter and strong continuing FDI inflows."

A very interesting aspect of Vietnam right now, he reported, is that by removing the top four or five stocks in the market - because of the restrictions on foreign ownership and how investors access the market most money has flooded into the big stocks - the remaining valuations for the broader market are very cheap.

"In Vietnam, you have a two-tier market at the moment," he elucidated, "with some big former state-owned companies

perhaps in the oil or dairy sectors, they are liquid and that is where many people put their money, but they are amongst some of the most expensive stocks in frontier or emerging markets generally. However, underneath them there are a number of companies in the one- to five-billion-dollar range that will benefit from the same sort of growth path of Asia and China in the past 25 years."

"In fact," he said, "we are buying companies in the retail sector in Vietnam at nine to 11 times earnings, with much higher growth prospects than you will obtain in other ASEAN countries."

With GDP per capita surging, there is a clear path by reference to the more advanced countries of Asia that indicates Vietnam's retail market will explode with activity. "The key for us," Bokor-Ingram explained, "is that this is not complicated investing. Mobile phone shops, electronics goods, retailers, grocery stores, jewellery shops, these just require the right management and the right corporate governance," he reported.

"And the icing on the cake," he added, "is that Vietnam under any other criteria apart from access from foreign investors qualifies to be upgraded to emerging market status," he reported. We do not know when, but when it does happen, you are going to see a big re-rating of the market and particularly the consumer-focused sectors within the market. In short, Vietnam has the best prospects of any EM or frontier market in my view for the next five years followed, actually, by markets in the Middle East."

Growth is only a number

A guest quizzed the FCC team on India and China. "Here," Bokor-Ingram reported, "GDP growth is not the key metric, as wage growth and corporate earnings growth are far more relevant measures. You can't possibly have an economy the size of China continuing to grow at 8% after many years of rapid growth, so you will see those GDP growth rates in China and even India have dropped."

He then pointed to examples that support his thesis. In India, the private bank and mortgage market is robust, he said, so investments such as HDFC, or Kotak Mahindra are outstanding opportunities, as these private firms are competing aggressively with the sluggish state banks and offer customer-centricity leading to growth rates in the teens.

In China, Bokor-Ingram and his team like insurance. "One of the outcomes of slower GDP growth is the government has somewhat less easy money, so the administration is pushing people towards private insurance for healthcare, private education, or life insurance. He also highlighted China Gas, as the government are pushing people towards cleaner and cheaper energy.

And in Brazil, as a further example, he pointed to a company that has a monopoly position in dental insurance. "Healthcare is very underfunded by governments in most emerging markets," he noted, "and when we see populations achieving a certain wealth level, people start to spend more of their income on healthcare. This company has a 70% market share for dental insurance and is growing its top line at 20% a year and trading on a P/E ratio of just 14 times."

"Our approach is always to seek out sustainable compound growth in earnings and cash flow, as well as requiring shareholder interests to be aligned with ours"

Meet and greet

"Our approach is always to seek out sustainable compound growth in earnings and cash flow, as well as requiring shareholder interests to be aligned with ours, Bokor-Ingram elucidated.

"Regular management meetings are a key principle of the process," he said, "and we like to find companies we can invest in for the long term, so belief in the sustainability of their growth and evidence of good shareholder relations are key drivers for us. Portfolios are built based on our conviction, and if we don't like a stock, we don't invest in it, regardless of its index weighting."

As well as extensive research trips, Fiera reaches out to its many industry contacts. "We update a detailed company financial model for each portfolio company with meetings and on-site visits key to the process," he reported. "We conducted over 600 company meetings in the last year. And valuation techniques include both relative and absolute measures. As to idea generation, the team seeks a flow of insights from many sources including relationships built up with local financial intermediaries over many years, as well as from competitors, customers or suppliers of existing holdings."

Governance and quality

Bokor-Ingram highlighted the importance of corporate governance from all aspects, including respect for minority shareholder rights, appropriate dividend distributions, fairness in related party transactions, fair valuation for transactions and so forth.

"We look for companies where we can trust the management to look after our interests, in short, but we reckon that about 75% of those companies we meet do not reach the standards we expect, especially former state companies and private companies run as the founder's private wealth vehicles," he reported. "Over the past 30 years, we have experienced the thousand ways that money can disappear, so this is a huge focus for us in any investment that we make."

The cult of the active

The discussion turned to the debate over the value of active versus passive strategies. "We are of course dedicated to active," said Bokor-Ingram. "We believe the only way to make money in emerging markets going forward, and to outperform, is active in the absence of any likely super-cycles. The overall investment strategy of our EM business in London is bottom-up, with target investments distinguished by three key pillars based on our proprietary scoring system. In brief, this determines quality, growth and valuation. This allows us to identify businesses that can grow strongly over time, maintain their margins over time, maintain their competitive positions, that have good management."

He added that while he is an especially firm believer in active for EM and frontier markets, fund flows into those markets have been some 80% drive by passive, especially ETFs. "Thus far," he said, "the global investment community has not yet decided that active is the way to go because I think people are still trying to make too many global asset allocation decisions, and EM is at the biggest underweight in global portfolios of any time in the past decade.

Duhamel then offered his own view on active versus passive, explaining that his career in the past was significantly passive, but that Fiera has had immense success growing its active AUM to some USD167 billion today. "It is important to understand that our main strategies are not driven by benchmarking, so for example our global equity franchise now is USD30 billion roughly and we are in the top 1% of all managers over any periods you choose, 10 years, 5 years, 30 years, whatever it is."

The Magna Strategy over the last five years, on average, has had 80% non-benchmark holdings relative to the MSCI Frontier Markets benchmark.

Sell when targets are hit

Bokor-Ingram also highlighted the differentiation of Fiera's 'sell' strategy. "We have a target price for every stock, a combination of DCF valuation plus peer group multiples, and when companies reach their target price, we sell; we will never own companies just because we like the company. We adopt a very strict sell discipline across all the portfolios. Moreover, we will never run billions and billions of dollars in EM, because that would constrain our ability to change our

mind, either due to valuations, or due to changes in government policies on reforms, which of course we cannot predict."

Bokor-Ingram offered some examples of the types of opportunities he and his team can unearth with these strategies and these disciplines. He first mentioned a ports company in the Philippines with 30 EM ports globally, and for which it is extremely tough for anyone to compete or drive margins down.

Disciplined approach

He explained that leverage was high when this company was building its portfolio of ports, but it is now highly cash generative, it has paid down debt, has a clean balance sheet, and is producing 10% to 15% revenue growth every year, offering investors a 6% dividend yield, which continues to rise. "There are plenty of other examples of this phenomenon in our portfolio, whether it is in Chinese insurance, or the Indian mortgage market, or Brazilian healthcare market," he reported.

He then explained that the frontier market portfolio is broadly dominated by domestic growth; there is very little exposure to metals and mining, oil and gas, or cyclical industries.

"In short," he concluded on this point, "passive has been a pretty good place to be when you have been in a global equities super cycle, but is a much more difficult place to be today, when active is far more likely to produce performance."

Seeking EM dividend plays

To close the discussion, Bokor-Ingram also mentioned a second key topic for the day, namely the firm's emerging market dividend strategy, which he said is focused on growth companies with low debt that also pay out high and/or rapidly rising dividends, with the portfolio offering a current yield of about 4.6%.

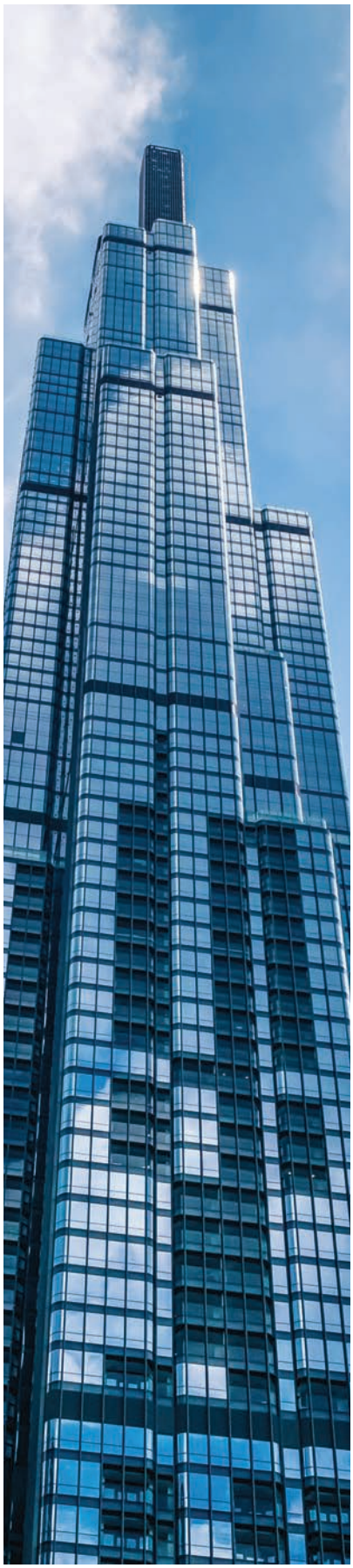
"The combined effects of dividend investing over the last 10 years accounted for approximately 50% of the return of any EM," he added, "so as EM companies continue to deleverage, free cash flows are rising, while growth can also be maintained."

He said that the broader EM universe is meanwhile on a roughly 3.1% yield and perhaps more importantly, net debt to EBITDA in the portfolios is roughly 0.3 times, whereas the market broadly trades at about 1x net debt to EBITDA. "Accordingly, we offer a much more defensive portfolio if we have a stress event in credit markets globally, even though I should add we are not forecasting one."

Staying the course

His final word was that there are clear cost and other factors driving some firms out of EM and frontier markets, as too expensive to cover and to maintain active strategies. "But we remain committed to these markets," he reported, "and we are in fact launching a new strategy by the end of this year which will look at the smaller emerging markets plus the larger frontier markets. These are interesting times for us."

By the time the discussion closed, guests had been treated to a bird's eye view of the world of frontier market investing from experts with both the experience and track record to merit the attention the attendees clearly gave throughout the discussion, as well as learning of the EM dividend/growth stock opportunities that Fiera also highlighted. ■



Fiera's Keen Focus on Asia to Promote its Frontier and EM Dividend Strategies

Fiera Capital (FCC) is a leading Canadian investment management firm with a total AUM of approximately USD127 billion, which promotes itself as offering thoughtful investment solutions to suit a variety of investor needs.

"Our mission is to provide clients with the highest quality of customised service and performance through a culture of integrity, teamwork, excellence, and innovation," the firm's literature states.

FCC was founded in 2003 and has been publicly traded since 2010. The firm has over 750 employees including more than 175 investment professionals and has approximately USD127 billion under management.

FCC is roughly 56% publicly owned, with the firm's management holding 19% and National Bank of Canada the next largest holder at 18%, as well as Desjardins Group at 7%.

FCC has a growing footprint in Asia, which was substantially enhanced in the USD65 million mid-2018 acquisition of Clearwater Capital Partners, a leading Asia-focused credit and special situations investment firm headquartered in Hong Kong with approximately USD1.4 billion of assets under management at the time.

Vincent Duhamel, Global President & Chief Operating Officer of FCC, explained to guests at the October discussion in Hong Kong that the firm has been diversifying in recent years, for example through the Clearwater acquisition.

"Our strategy," he said, "is essentially to find teams of people wherever they are around the globe, whatever asset class they work in, that are able to generate alpha for the clients, that offer a skill set that we don't have and that help us offer better portfolios for our clients. Clearwater is a good example of that." ■

The Participants from Fiera Capital

Dominic Bokor-Ingram, CIO

Bokor-Ingram joined Fiera Capital (Europe) in 2013 as part of the team focusing on frontier markets. He previously held a series of senior positions at Morgan Stanley, Goldman Sachs and, from 2006, Renaissance Capital, the EMEA investment bank operating in high opportunity emerging and frontier markets.

He began his career in financial services in 1989, initially specialising in closed-end strategies and then, from 1992, in emerging markets. Between 1995 and 2002, he worked for Regent Pacific, from which Fiera Capital was demerged, where he was responsible for 23 Eastern European strategies. Bokor-Ingram is an economics and statistics graduate from the University of Exeter.

Vincent Duhamel, Global President & Chief Operating Officer

Duhamel is Fiera Capital's Global President and Chief Operating Officer. As a member of the Global Executive Management Committee, he oversees distribution operations and corporate units such as Legal and Compliance, Risk, Technology, Corporate Communications and Investor Relations, as well as Human Resources. As a member of the Strategic Development Committee, he also plays a major role in strategic acquisitions while overseeing the firm's development outside of North America.

Before joining Fiera Capital, he was Partner and CEO at Lombard Odier in Asia and responsible for operations in Hong Kong, Tokyo and Singapore. From 1997 to 2011, he worked in Hong Kong, first as the Senior Principal and Chief Executive at State Street Global Advisors Asia, then as the Managing Director at Goldman Sachs Asset Management Asia, and after as CEO of SAIL Advisors, a private family office.

During his time in Asia, he played a key role in the market intervention and disposal of assets by the Hong Kong Monetary Authority during the Asian crisis, in addition to managing a project to help the Social Security Fund of China develop its investment processes and policies.

Since the early 1990s, Duhamel has sat on numerous boards and committees, including Chairman of the Board of Governors at the CFA Institute, the Stock Exchange of Hong Kong, the Securities and Futures Commission of Hong Kong, and the Financial Reporting Council of Hong Kong, to name a few.

Stephen King, Head of Institutional Sales APAC

King joined Fiera Capital in August 2017 covering institutional business. He relocated back to Singapore in December 2018 to lead Fiera Capital Asian Distribution. Previously he held positions at the Rohatyn Group where he was Head of Institutional Sales and was responsible for maintaining consultant relationships. He started his career with Mizuho Bank in Structured Finance, and has had a long affinity to Asia, even having been born in Hong Kong. He holds a BA in Business Studies from the University of the West of England. ■