# A calculated approach to emerging markets

*The benefits of being selective*

In our latest Fall Exchange Event Series webinar, Arup Datta, Head of the Mackenzie Global Quantitative Equity Team shared the benefits of a disciplined approach that combines a nimble human centric perspective with daily trading and rebalancing that can help identify opportunities by being more selective.

The 10-year growth outlook for emerging markets (EM) remains positive relative to global peers. Institutional investors have been investing in EM for some time now but have been increasing their allocations lately. For example, over the past decade the CPP has raised its EM public equity exposure from 10% to 24%.

**Outlook**

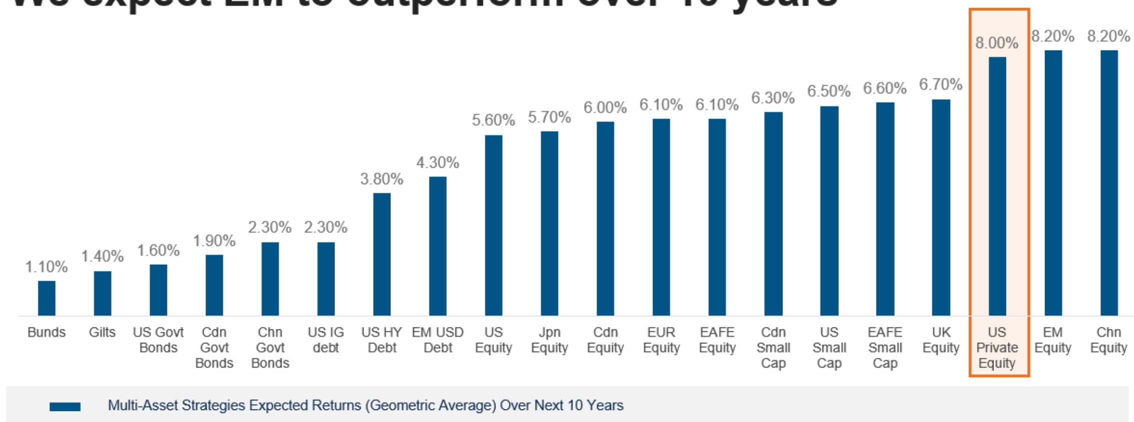
EM has performed the best over the past 20 years, with the MSCI EM index posting a CAGR of 9.8%, versus the S&P 500's 7.7%. More recently, however, the US has outperformed EM, with the S&P 500 returning 18.2% over 10 years, versus 8.2% for MSCI EM.

In the last year, EM has come roaring back with the MSCI EM ex-China index returning 30.5%, versus 23.4% for the S&P 500. The MSCI China Index, however, has lost 11.7%.

"With [China's] move to 'prosperity for all' under President Xi, and going against some of their monopoly leadership, the market hasn't done well," Datta said. "But my view is that EM has done very well over the long run, and in the short run is making a strong comeback, with China being a laggard right now, but I think that will catch up."

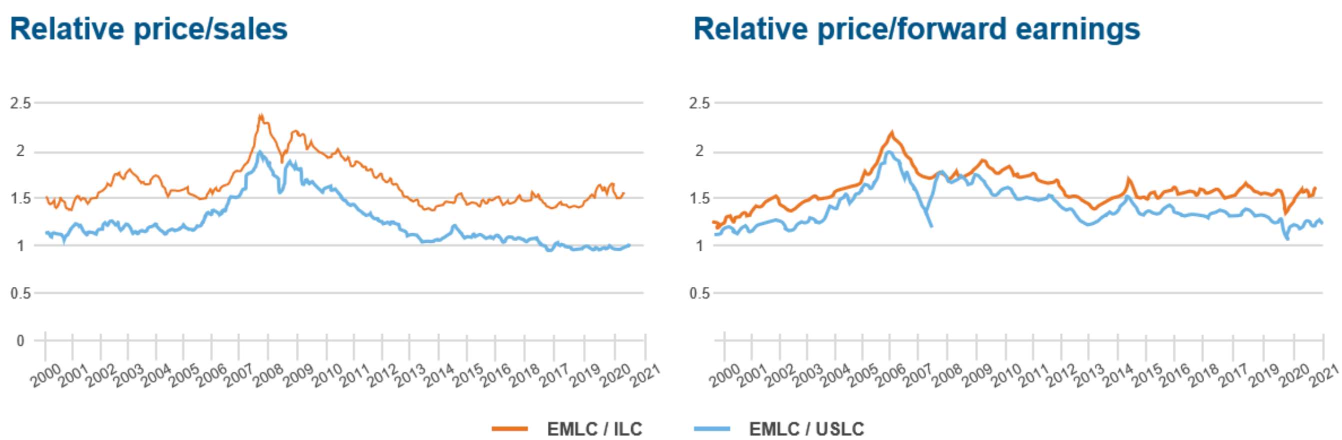
He pointed to the market expectations of Todd Mattina, Mackenzie's Chief Economist and co-lead of the Mackenzie Multi-Asset Strategies Team, who projects EM equity will outperform over the next 10 years, with returns of 8.2%. This eclipses his 5.6% expectation for US equity.

## We expect EM to outperform over 10 years

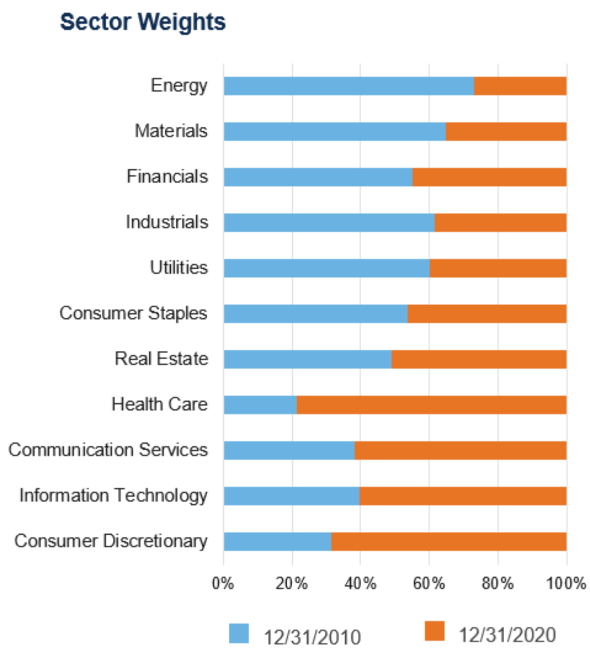



Mackenzie's expected returns as of 12/31/20 are shown on a nominal basis, before fees for all asset classes. Management fees will vary by asset class, with higher expected for private assets than for public assets. Over a 10-year horizon, returns will tend to converge to the combination of the risk-free rate and the asset class risk premium, as active return expectations will gradually decay over time. Developed-market sovereign bond returns shown here reflect the expected return to investing in a constant-maturity, 10-year government bond. Further details on how Mackenzie developed these expected returns, including regarding the assumptions used, are available upon request.

Comparing relative price/sales valuations between the EM and US, emerging markets have rarely been more attractive. By the same measure, EM looks about average versus the broad international market.




The make-up of the EM index has evolved over the last 10 years, with primary materials and energy making up far less of their sector weights, while IT, health care and consumer discretionary have grown dramatically.




**The quant advantage**

Emerging markets represent a sweet spot for quantitative investing, Datta said, as the universe of stocks is so large. It would be very difficult for a fundamental manager to develop a deep knowledge of so many companies within this space.

A quant approach relies on computing power to generate a broad knowledge of the stock universe and employs proprietary risk and transaction models. This allows the team to react quickly to the latest information on any given stock.

"The breadth of the emerging markets, with 7000 stocks, plays into a quant's strengths. I would not make the same argument if we were talking about Canada or US large cap."

**Keys to success**

He believes there are three elements that contribute to the success of his team's investment style:

**Core approach**: The team seeks a balance of factors with an aim of adding value across a variety of market conditions. These include four "super factors":

- Valuation versus peers
- Revisions to forecasts by sell-side analysts
- Quality of management, operating efficiency and ESG aspects
- Informed investor activity

**Disciplined process**: The stock selection process is driven by factors grounded in research and guided by a strong focus on consistent portfolio structure and risk management

**Daily rebalancing and trading**: This allows the team to incorporate the freshest rankings into the portfolio based upon new information with a strict focus on capacity management and efficient trading.

They also employ natural language processing software to scrub through financial statements and management discussion and analysis documents. While they currently have this capacity for English documents, they are close to rolling out this capability for Chinese and Korean, which will enhance their data for the three largest components of EM: China, South Korea and Taiwan.

**The human touch**

While the quant models he employs do the heavy lifting in terms of data analysis, the portfolios still require human intervention at times. He says the last 18 to 21 months have been the hardest he's worked in terms of investments, since the global financial crisis.

"In times like this, you need to do a little bit more handholding in a very disciplined quant process," he said.

"Quant models don't know about pandemics and therefore when the initial news came out of China, the markets corrected, the airlines (for example) took a hit. The models would (recommend we) go out and buy those, but that's when me and my team decided not to buy them. That's where we stepped in and did not buy companies like airlines and hotels."

competition, technological change, changes in government regulations, changes in tax laws, unexpected judicial or regulatory proceedings and catastrophic events. Please consider these and other factors carefully and not place undue reliance on forward-looking information.

The forward-looking information contained herein is current only as of September 8, 2021. There should be no expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

We may record calls and monitor live calls with our sales representatives for training and quality assurance purposes. For more information, please see our privacy policy.

Your privacy is important to us. Please review Mackenzie Investments' Privacy Protection Notice at: mackenzieinvestments.com/en/legal/privacy-protection