

Beyond the Index: How Stock Selection Drives Long-Term GEM Returns

Stock selection has been the key factor in generating long-term returns for our Global Emerging Markets (GEM) Strategy. Over 80% of the alpha that has been generated through our portfolio has come from stock selection.

If you look at the returns from emerging markets in isolation, they have been modest, especially in comparison to other areas of the world over the last 15 years. But with the right strategy, looking at specific companies and backing your investment judgement, you can generate significant returns. Finding the right company at the right valuation ultimately is what makes the difference.

At the heart of our process is the fact that individuals are ultimately looking to have a better life, better opportunities, earn more money and spend that money. There are a significant number of people who have achieved opportunities in life through education, who are looking for better employment prospects, inevitably moving to cities and who have a very strong work ethic.

When people have the opportunity to have a better education, better form of employment and earn more money, they will spend that money differently. These trends have been established for many decades in the developed world, and we see them every day across the emerging market universe.

This is why we believe emerging markets remains an attractive investment category. The opportunity is significant, supported by powerful demographic trends, particularly in Asia where over half the world's population resides, alongside a very young population. We also see strong growth dynamics in regions such as Latin America.

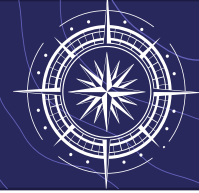
The case for active management in emerging markets is clear. The index itself includes a wide range of industries, many of which do not generate attractive returns. As a result, emerging markets has traded at a lower multiple compared to other regions. However, by focusing on specific companies and applying disciplined stock selection, it is possible to generate meaningful outperformance.

We are also seeing a point where emerging markets appear to be trading at levels where the degree of underperformance relative to developed markets looks quite dramatic, and therefore there are grounds for reversal. That is reflected in the valuations we see across the opportunity set.

The investable universe continues to expand. There are many companies coming to market through public listings, which provides us with the opportunity to meet these businesses, assess their prospects and invest accordingly. Rather than trying to cover the entire universe, we focus on companies that generate attractive financial metrics, strong cash flows, good levels of profitability and the ability to fund their own future expansion.

A key part of our process is focusing on return on equity. Generating a return of 15% over the equity of a business is not easy, and businesses that can deliver this year after year are typically high-quality companies. That excess cash supports profit growth and provides the opportunity to reinvest in the business, creating a powerful combination for long-term returns.

Much of the opportunity we see is driven by structural changes in consumption and technology adoption. For example, the development of digital ecosystems such as WeChat has transformed consumer behaviour. Over one billion people use the platform daily for messaging, payments, e-commerce and services, creating strong customer loyalty and multiple revenue streams.

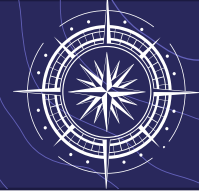


Similarly, financial inclusion in markets such as India has been transformational. Prior to 2012, only 20 million people had a bank account. Today, that number has increased to over 500 million. The widespread adoption of smartphones, supported by low-cost data, has accelerated this shift and created significant opportunities across the economy.

Despite the breadth of opportunity, discipline remains critical. We focus on established operators with management teams that have proven themselves through economic cycles. Many of the businesses we invest in operate at a domestic level and are leaders within their markets, benefiting directly from changing consumption patterns.

There are many companies to invest in, and our role is to identify businesses that combine strong management, cash generation and attractive valuations. We also maintain strong alignment with our investors, with senior members of the team investing their own capital alongside clients.

You can buy the index, and ETFs may appear cheap, but over the long term, having a good active manager with a track record of stock selection is, in our view, the most effective way to generate alpha.



Biography

John Ewart | Investment Manager



John is a Director of Aubrey, and Investment Manager of the Global Emerging Markets Strategy. He joined the firm in 2012.

John is a graduate of the University of Strathclyde, with a BA in Economics and, additionally, is a member of the CFA Institute.

John has over 30 years' investment industry experience across global equity markets. He joined Glasgow-based FS Assurance in 1988, and managed equity portfolios in the UK retail and pension fund market. He then moved to First State Investments in 2000 to manage retail and segregated European client portfolios. In 2004, he moved to Alliance Trust PLC and was a member of the Global Equity Team and subsequently responsible for the Global Emerging Markets portfolio.

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