OPALESQUE
ALTERNATIVE MARKET BRIEFING
Tuesday, July 05, 2022

The Big Picture: Current opportunities in China and LatAm

B. G., Opalesque Geneva:

The MSCI Emerging Markets Index was down almost 12% YTD at the end of May. And hedge funds are not doing much better as the HFRI Emerging Markets (Total) Index declined five consecutive months to start the year, falling -10% YTD through May, and the Eurekahedge Emerging Markets Hedge Fund Index is down -3.5%. But not all is gloom: emerging markets have their own cycles, and there are opportunities in places that benefit from commodity exports and private credit according to some, and it may be a good time to buy, say others.

Charlie Wilson, managing director at Thornburg Investment Management, gives us his take on the emerging markets' investment environment. He co-manages the Thornburg Developing World Fund, a $1bn equity portfolio that invests primarily in companies in emerging markets. The fund has annualised a return of +6.6% from inception in December 2009 to March 2022 - compared to +3.7% for the MSCI Emerging Markets NTR. Thornburg has $44bn in client assets and is based in Santa Fe, New Mexico.

Opalesque: What is the opportunity set in China?

Charlie Wilson: One of the surprises coming out of the Covid pandemic was how well China navigated the initial stages post-Covid. They were able to get back to work quite quickly. It was similar for both South Korea and Taiwan.

Unfortunately for China, they have remained in a zero-Covid policy framework which has hurt them more recently as the new variants become more transmissive, and so it is very hard for them to stop the spread of the virus through lockdowns alone. We have seen a large amount of China's GDP impacted in the recent past as they continue to pursue that zero-Covid policy. The leader coming out of the depths of the Covid crisis has become the laggard.

Layer on the fact that the Chinese Communist Party has been tinkering with policy, especially with respect to private industry, which was initially targeted toward the internet sector but has become more broad-based over time. There is a power struggle between the party and some private companies. That is also showing in consumer sentiment as animal spirits, which is another headwind for growth.

China is an area where there is a lot of opportunity; over the last year we have seen valuations reset quite substantially in China, and we are seeing the potential for them to get back to normal activity levels over the next few months and for more aggressive government support.

Opalesque: What about LatAm?

Charlie Wilson: Last year, we saw several elections or anticipations of new elections across Latin America that

Copyright 2022 © Opalesque Ltd. All Rights Reserved.

have led to some disruptions. In Peru and Chile for example, and Brazil this year, where we are going to see a new presidential election, elections have led to concerns around new policy adjustments that might be either in the pipeline or coming.

We are seeing parts of LatAm that have done a good job of vaccinating and getting back to work, where we start to have concerns about any potential policy changes in a variety of sectors, whether it be mining or extractive industries or policies of work program that lower the fiscal budgets, etc. That's an area where we are seeing extraordinarily depressed valuations that are quite attractive at this point.

Opalesque: What about the risks in LatAm?

Charlie Wilson: Typically when you come out of these phases of hype or escalated fear around political cycles within LatAm, it is a good opportunity to buy because it has never been as bad or as good as the markets think it is. And generally, for example, let's say if you have a left-leaning president, it's usually offset by a right-leaning congress so there is only so much they can do.

That's our guiding principle regarding LatAm: it is never as good or as bad as you think it is - and that presents opportunities.

Normally in an environment like this, we have really elevated commodity prices and that's usually very good for LatAm, especially countries like Mexico, Brazil, Chile, and to some extent, Argentina. But because of this political uncertainty, we are seeing very strong earnings in some of the export industries and commodity industries. Even in domestic consumption stories. But the valuation has come down mainly because of these concerns.

Opalesque: What is your current country exposure?

Charlie Wilson: Right now our largest position is in China, which is above 30% of the portfolio. Our second largest position is Taiwan. This is followed by India and Brazil - each about 10%.

Opalesque: What investment shifts have you made in terms of geography?

Charlie Wilson: The primary shift that we have made over the last six months or so has really been a reduction in our exposure to Russia.

Our stock selection process is focused on businesses that have a dominant position in the markets or value chains, so from a commodity producer perspective, we look for low-cost producers that might have a resource base that is definitively better than the rest in the industry. We look for the best commodities from lower-cost producers.

Unfortunately, last year the best opportunity set for companies in extractive industries was in Russia. They are the stand-out leaders in oil, gas, mining, etc. So, most of our commodity exposure was in Russia. That has been a long-term holding for us. We have benefited both from stronger commodity prices as well as dividends.

Furthermore, Russian companies that want access to global markets have done a great job on the ESG side. They have made great strides, making sure they have independent boards and professional management teams. Those were the kind of companies we were trying to align with.

Copyright 2022 © Opalesque Ltd. All Rights Reserved.

Sadly, the war broke out. It was unexpected to us as we had expected a diplomatic solution in this case. Once we realised we were going to see an armed conflict, we decided to exit our Russian positions. Fortunately, we were able to exit all Russian positions before the markets froze. We re-allocated much of that capital to other commodity producers around the world located in places such as Thailand, Brazil, and India.

Opalesque: So out of Russia and into...?

Charlie Wilson: We also made minor changes in positioning: as China continues to struggle to reopen, the stock prices there became more and more attractive, so we continued to add to our favourite China holdings and established some new holdings. We saw several opportunities that were sensitive to re-opening in China or general economic recovery. Secondly, as the LatAm markets continue to lag, we have continued to add to some positions there both on the domestic cyclical side in the expectation of recovery and in the big commodity producers I mentioned.

On the other side, India has been a stand-out in terms of valuation. Markets and valuations continue to remain at all-time high levels. So that has become increasingly less attractive, especially in a high commodity price environment. They don't benefit from high commodity prices because they are primarily an importer of commodities, so we have seen inflation starting to pick up a bit.

Opalesque: What about your exposure to financials?

Charlie Wilson: We have noticed increasingly attractive opportunities in financials, partly tied to interest rates moving higher globally. That usually benefits banks that have good deposit funding - typically banks that have focused on strong deposit franchises and usually have the lowest-cost funds in the system.

Also, over the last year, capital market activity has slowed substantially for a variety of reasons. Some of them are country-specific, and some of them are more global-market related. So, we have seen some good opportunities in businesses that are more tied to capital markets activity, for example, the equity and fixed income exchange in Brazil known as B3. We also own the Charles Schwab of Brazil, named XP, which is a digital online brokerage platform.

Longer term, financials have been a consistent overweight for us because we are very optimistic about the financial inclusion theme and the penetration of additional financial services in the many EMs.

Opalesque: And your exposure to consumer discretionary and technology?

Charlie Wilson: We quite frequently have an overweight in consumer discretionary and that is the case right now. Many emerging markets have yet to recover fully from Covid, partly because vaccinations were delayed getting off the ground. So there are some very early-cycle consumer discretionary-type stories. A good example is Tata Motors in India; they have a large domestic commercial and passenger vehicle business in addition to owning Jaguar Land Rover, so a big part of this is the recovery of the India business which is starting now.

We have also been overweight on technology for the last couple of years. Part of that was taking advantage of the shift to the work-from-home world which required additional consumer electronics. Part of that was a 5G upgrade cycle. Another angle to it is many traditional businesses recognized the need to move to the digital world. So, we own two IT services companies that we previously sold for valuation reasons last year but recently repurchased.

Copyright 2022 © Opalesque Ltd. All Rights Reserved.

Opalesque: How are EMs affected by Russian oil?

Charlie Wilson: Several emerging markets have partnerships with Russian producers. There are several Indian oil companies that also jointly own assets with Russian producers. The refineries in India do purchase Russian oil and they don't stick to the same international standards with respect to purchasing Russian commodities that others do.

That has been a benefit in the past and I think it will be again; it tends to be temporary because at some point the Russian suppliers will find a home closer to market prices. So now is a short-term period of over earning but this is not a prolonged event. A Chinese gas distributor recently told us they have access to Russian gas via a pipeline and they are seeing the benefit of that short term in their margins. That will even out over time.

Opalesque: How is market pessimism affecting EMs?

Charlie Wilson: It really feels like a lot of pessimism is baked into the markets at this point. Any dovish hint that the Fed throws out, markets skyrocket. If we see any type of turn and inflation - or just even a plateauing of prices - in the US or globally, that's enough to change perspectives.

One of the things that may not be apparent is that the inflation basket for emerging markets is much more tied to commodity prices. Commodity prices actually had easier comps in the second half. So many EMs are expecting inflation to normalise fairly early, towards the first half or the middle of next year. This gives central banks a lot of wiggle room to start to cut interest rates. Because they were aggressive in raising interest rates early on, EMs are also in a good position now to see the benefits of lower interest rates if inflation does in fact peak and fall.

Opalesque: How are investors reacting?

Charlie Wilson: Many people view EMs as risk, regardless of the starting point. This year, I remind investors of the period of 2004-2007 when US interest rates kept on moving higher, inflation was higher than normal globally, and EMs massively outperformed developed markets, specifically the S&P. The current environment feels a lot like that.

The broader argument is the starting point matters: valuations in EMs are very low and attractive and in some specific cases, markets like Brazil are at an all-time low. Then there is a backdrop that benefits some EMs and interest rates are already very high, which protects, and at times, strengthens the currency. That does not even take into account the longer-term tail winds around the rise of the middle-class within EMs, which is expected to double this decade.

If you go back to the global financial crisis of 2008, EMs bottomed about six months before developed markets. It feels like there could be a similar setup here because they are perceived as such high risk. This is good timing to be invested in emerging markets.

Past *Big Picture* articles here:

Article source - Opalesque is not responsible for the content of external internet sites

Copyright 2022 © Opalesque Ltd. All Rights Reserved.

Annualized Total Returns as of June 30, 2022	1-YR	3-YR	5-YR	10-YR	SINCE INCEP.
Thornburg Developing World Fund, Class I Shares	-28.76%	0.33%	3.49%	4.47%	5.30%
MSCI Emerging Markets Index	-25.28%	0.57%	2.18%	3.06%	2.64%

Class I shares date of inception: 12/16/09

Performance data shown represents past performance and is no guarantee of future results. Investment return and principal value will fluctuate so shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than quoted.

The maximum sales charge for the equity funds' A shares is 4.50%. There is no up-front sales charge for class I shares.

Important Information

The views expressed are subject to change and do not necessarily reflect the views of Thornburg Investment Management, Inc. This information should not be relied upon as a recommendation or investment advice and is not intended to predict the performance of any investment or market.

Investments carry risks, including possible loss of principal. Additional risks may be associated with investments outside the United States, especially in emerging markets, including currency fluctuations, illiquidity, volatility, and political and economic risks. Investments in small- and mid-capitalization companies may increase the risk of greater price fluctuations. Investments in the Fund are not FDIC insured, nor are they bank deposits or guaranteed by a bank or any entity.

Class I shares may not be available to all investors. Minimum investments for the I share class may be higher than those for other classes.

There is no guarantee that the Fund will meet its objectives. Portfolio attributes and holdings can and do vary.

Neither the payment of, or increase in, dividends is guaranteed.

The MSCI Emerging Markets Net Total Return USD Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of the following 24 emerging market country indexes: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. Indices do not take into account fees and expenses. Investors cannot make direct investments in an index.

Before investing, carefully consider the Fund's investment goals, risks, charges and expenses. For a prospectus or summary prospectus containing this and other information, contact your financial advisor or visit thornburg.com. Read it carefully before investing.