Uncovering opportunities in emerging markets

The quantitative approach and long-term view

Why Emerging Markets

Why is now a good time to invest in emerging markets?

1. Performance: EM and China have shown strong long-term returns over the last 20 years. Looking forward, EM and Chinese equities are expected to stay ahead (8.9% and 8.8% respectively) over the next 10 years, compared to other asset classes.†
2. Valuation: emerging market valuations, as represented by price/sales and price/forward earnings, are at an all-time low, so EM look very cheap compared to the US over the last 20 years. There is also a reasonable valuation support for EM versus international.
3. Country and sector exposure: the EM story is not that different from the rest of the world. It has been evolving from old economy/country/sector to the newer economy/country/sector.
4. Diversification: EM are not just about China. Over the past 10 years, they have had a more diversified story, with Taiwan and India leading the way.

Why a quantitative approach

How is our approach different from fundamental managers? Why do we consider emerging markets to be the perfect sweet spot for investment?

1. Quant advantages versus fundamental
   a. Powerful technology to rank stocks quickly, on a daily basis.
   b. Fundamental analysts/PMs do a deep dive into each company they invest in (only 30-40 companies are covered by each analyst). Conversely, quant covers a wider breadth of companies (7000+ stocks).
   c. We use an in-house-built proprietary risk and transaction cost model, due to the high-risk nature of EM markets.
   d. Daily rebalancing and trading are huge advantages: they allow us to get into names that have a favourable outlook early and get out of them early when the fundamentals have been changed.

2. EM sweet spot for quants
   a. EM are less efficient, with fewer active managers, which leads to a higher alpha potential. This is especially true with small cap names.

Why Mackenzie Global Quantitative Equity Team

What are the key advantages our quant team brings to investing in emerging markets?

1. Core approach: designed to add value in different market conditions, whether that is in a value- or growth-driven environment.
2. Disciplined process: consistent portfolio positioning by implementing factor tilts versus the benchmark.
3. Daily rebalancing and trading: daily ranking of 7,000+ stocks, incorporating the latest information.

What is the team's factor process?

The team uses a balance of four super factors: value, revisions (growth), quality and informed investor.
Underneath each super factor, the team looks at roughly 20 sub-factors per stock, and those factors continuously evolve through a vibrant research agenda.
New factor highlights: innovation (revisions), ESG (quality), etc.

Some recent research the team has carried out in the past:

1. Chinese model
   - Breaking China out from the rest of Asia, as China has more growth names than any other Asian countries, such as India and Taiwan.
2. Machine learning, big data, natural language processing
   - The model is already in place for US strategies: looking through company filings and transcripts, and using text-parsing techniques.
   - Research is also carried out in Korean and Chinese languages, and will be brought to the live process for EM in the coming months.

<u>Why is implementation so critical for our team and its success?</u>
For quant managers who like to rebalance and trade daily, it's very critical to have the implementation aspect in place. Transaction costs are always considered when the team makes its decisions, in terms of buying and selling stocks based on their daily ranking. Additionally, the team also limits capacities for all of its strategies, so as to stay nimble and be able to get in and out of names at the right time.

By implementing a daily trading process, the team can generate strong short-term alpha potential. On average, each trade has generated 14 basis points at the trading day +5, which is something that cannot be captured by managers who don’t have a daily trading process.

<u>How does the portfolio look today versus its benchmark?</u>

1. Diversified portfolio.
2. Slightly lower in market cap, to take advantage of smaller cap alpha opportunities.
3. Value bias: higher dividend yield, lower price to cash flow.
4. Growth bias: higher earnings, sales and target price revisions.
5. Quality bias: higher free cash flow margins.

In summary: the portfolio is slightly low in market cap compared to the broader market, but with a sizable value, growth and quality tilt (core focus).

<u>How do you handle Russia in your portfolio? How do you deal with the geopolitical risk?</u>

The team made a human decision, not a model decision, to cut down the overweight on Russia to neutral. It shows the team's ability to include a human approach to the investment decision process when encountering extreme situations.

When measuring country risk, the team looks at different characteristics. For example, the team allows +/- 3% over- and under-weight on countries like India or Taiwan because of their relative low risk. Considering Russia is riskier than India and Taiwan, the weight to Russia has been limited to 1.5% since last December.

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†Mackenzie's expected returns as of 12/31/21 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. Further details on how Mackenzie developed these expected returns, including regarding the assumptions used, are available upon request.

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