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## Hunting for value in emerging markets

Letko Brosseau takes a decidedly fundamental approach to the companies it selects for its EM fund.

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Conventional investment wisdom suggests diversifying one's portfolio with emerging market (EM) exposure. And why not? EM economies account for two-thirds of global economic growth, and fueled by population growth and an expanding middle class are growing twice as fast as developed markets. Even considering such positive, long-term, structural growth characteristics, emerging markets are trading at a modest 10 times earnings — a significant discount to the S&P 500 at 20 times earnings.

But getting the greatest value from EM equities involves far more than simply allocating a share of a portfolio to China or India. For Rohit Khuller, vice president, investment management and partner with investment management firm Letko Brosseau, finding value in each opportunity requires a thorough understanding of a country's economy and politics in addition to a fundamental analysis of the prospects of each company represented in the Letko Brosseau Emerging Markets Composite fund.

Khuller's first career was in engineering, but his life was changed through his exposure to some of the world's best business professors while pursuing an MBA at McGill University. Combining the analytical skills of



Emerging market economies account for two-thirds of global economic growth.

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an engineer with a strong knowledge of capital markets, he joined Letko Brosseau in 1998 and launched the firm's EM fund in 2011.

"I was born in India, and I believe my upbringing in one of the world's largest emerging markets gives me an edge," he says. "But I also have an eye for companies that offer the potential to make money."

He notes that it's easier to invest in countries such as China when all boats are rising on an economic tide, but as recent economic news bears out, emerging markets have been more volatile than developed ones.

That's why Letko Brosseau's EM strategy looks to both superior growth rates in EM economies and painstaking research into the companies the EM fund rep-

resents. Khuller is assisted by senior portfolio managers Yongai Xu and Mila Krasniouk, and 22 other seasoned investment analysts organized by global sector — many with on-the-ground experience in the industries and markets they represent.

The resulting EM fund is a high-conviction portfolio of 50 to 60 companies that demonstrate characteristics of long-term competitive advantage, strong earnings, and cash-flow potential.

Letko Brosseau seeks to mitigate the risk of its EM fund by carefully diversifying the portfolio across countries, regions and industries — while avoiding over-leveraged companies, or those trading at excessive valuation.

"We never follow the index," Khuller says. "For ex-

ample, when China represented 43 per cent of the MSCI Emerging Markets Index in Oct 2020, we felt that was too much risk. We're also in India, Poland, Brazil, Peru, Indonesia, Thailand and the Philippines, so we are not significantly impacted by results from one sector, one country or one region."

The fund strategy always remains as a guiding force. Understanding, for example, that the strength of India's economy depends little on exports, Letko Brosseau's India exposure includes consumer-facing companies such as well-capitalized banks and Reliance Industries Limited, a company tasked with rolling out the country's largest cellular networks at the same time as it manages one of the world's largest oil refining hubs.

However, the EM fund exhibited exposure to Indian information technology company Infosys Ltd. in 2021, following a sudden steep increase in stock valuations to an excessive 25 times earnings.

The EM fund also focuses on companies with defensive growth characteristics, with a preference for contracted and visible cash flows earned from long-lasting infrastructure assets. This includes companies such as Mexican airport operator Grupo Aeroportuario Centro Norte (OMA).

"OMA has long-term contracts to manage 13 international airports in Mexico, and they have highly visible cash flows," Khuller says. "The government gives them a fair return on capital for their regulated part of the business. But the non-regulated side includes food and beverages, duty-free, car rental, and parking facilities, which are growth engines for the firm."

The EM fund also focuses on firms that are returning capital through dividends and buy-backs, with dividend yield across the fund averaging five per cent. While dividends can provide comfort in turbulent times, Khuller's team wants to know how those dividends are paid — from earnings, or through the issuance of new equity or debt.

The strategy appears to be paying off. The Letko Brosseau Emerging Markets



Rohit Khuller, vice president, investment management and partner with investment management firm Letko Brosseau. SUPPLIED

Composite fund has offered 7.7 per cent compounded annualized returns since its launch in July 2011\* against benchmark returns of just 5.0 per cent.\*\*

"By 2025, the economic output of emerging markets is expected to eclipse that of developed economies," Khuller says. "By adhering to a time-tested, classical fundamental approach to selectively harness that growth, our emerging market strategy is well positioned to create long-term sustainable value."

For more information on Letko Brosseau and Associates, Inc., visit: <https://www.lba.ca/>

\* As of December 31, 2022.

\*\* 5 per cent Deutsche Bank Fed Funds Effective Rate Total Return Index, 95 per cent MSCI Emerging Markets Total Return Net Index.