

Mitigating risk in emerging markets through ESG integration

For Letko Brosseau's EM fund, ESG is part of its fundamental investment philosophy

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It's often challenging for investors to capture the growth advantages of emerging market (EM) opportunities, while both mitigating volatility risk and ensuring these investments meet their environmental, social and governance (ESG) criteria.

Investment management firm Letko Brosseau has incorporated all of those attributes into a tidy bundle with the Letko Brosseau Emerging Markets Composite fund. Incorporating ESG into its fundamental investment philosophy since the fund's inception in 2011, its managers believe those characteristics represent part of the fund's ability to generate consistent returns and ride out EM volatility.

Letko Brosseau is bullish on emerging markets because they represent 84 per cent of the world's population and account for two-thirds of global economic growth. In addition, the price-to-earnings ratio of the EM fund traded at a modest 9.5 against 12.6 for the MSCI Emerging Markets index and 19.0 for the S&P 500 (as of March 31, 2023). However, investors in developed markets often limit their EM allocations, in part to shield themselves from the greater level of volatility in emerging markets experienced by investors over time.

Letko Brosseau's EM strategy permits the fund to fully participate in the growth of emerging markets, while



Letko Brosseau has been incorporating ESG into its investment philosophy for more than a decade. PHOTO BY GETTY IMAGES.

offering investors strong downside capture in difficult times. The firm's team of 23 seasoned investment analysts specialize in well-defined global industrial sectors, and many of them count on-the-ground experience in the industries, markets and countries they represent.

"We understand that emerging markets have not been as efficient in their regimen for ESG disclosure," says Yongai Xu, senior portfolio manager and partner at Letko Brosseau. "While this may represent an added challenge to many investment managers interested in emerging mar-

kets, we attribute part of the fund's lower risk profile to the integration of the ESG dimension into our fundamental investment approach."

Xu was born and raised in Shanghai, and she counts her cultural understanding of countries such as China as a distinct asset in informing Letko Brosseau's EM strategy.

"Many of our team members go beyond a simple academic interest in the countries they represent," she says. "They've been there, they've lived there and actually understand those countries from the bottom up. From China and India, to Russia,

Ukraine and Nigeria, it's a very diversified team."

Because each of these analysts specialize in one industry, they understand the ESG analysis framework specific to that industry. Looking at emerging markets, they apply that same understanding to Letko Brosseau's EM strategy.

"We hold EM companies to the same standards but understand that they have not all made the same progress as developed countries," says Xu. "For example, even if part of the country's energy mix includes coal, we look for investable ideas, or companies that can contribute



Yongai Xu, senior portfolio manager and partner at Letko Brosseau. SUPPLIED.

to an energy transition. Even if progress is slower, by investing in those companies we get a seat at the table and make those companies aware of both the challenges they face and the opportunities they have to rise above them."

Xu recalls one EM fund company whose subsidiary had plans to build a greenfield coal plant to provide a baseload energy source to support potential renewable energy projects.

"We communicated to the company that we believed they could lower the carbon footprint for their plans," she says. "It didn't happen overnight, but they were eventually convinced to give up the coal plant in favour of cleaner natural gas."

The fund also considers the governance of those companies in which it invests. Even though stock exchange regulations and rules governing

board composition vary from country to country, Letko Brosseau applies the same proxy policies to the 50 to 60 companies in its EM portfolio.

"We address those governance challenges by engaging with companies, explaining our preference for an independent board, for example," says Xu. "That may not change the situation immediately, but possibly over time. By prioritizing engagement over divestment, we make our voice heard."

In Letko Brosseau's experience, EM companies open to incorporating ESG and sustainability strategies are simply better managed, handle economic volatility better and tend to be more profitable. The Letko Brosseau Emerging Markets Composite fund has offered 7.9 per cent compounded annualized returns since its launch in July 2011* against the MSCI Emerging Markets Total Return Net Index of 4.2 per cent over the same period.

"We adhere to a time-tested, classic fundamental approach, focusing on growth opportunities in EM countries, and paying a fair price for world class businesses," says Xu. "By incorporating an ESG focus from day one, we believe our emerging market strategies are well positioned to create long-term sustainable value."

* As of March 31st, 2023.

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