REPRINTED FROM NOVEMBER 20, 2023

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Emerging Markets Offer Reasonably Valued Exposure to Growth

ALEX LETKO, CFA, is a portfolio manager and partner at Letko, Brosseau & Associates Inc. Prior to joining the firm in 2018, he worked in equity research at Barclays in New York, where he covered the oil and gas industry from 2015 to 2018. Previously, he was an associate with the economic research team at Evercore ISI in New York (2013–2015). He is a graduate of Columbia Business School University where he received an MBA, University College Dublin, where he received a master's degree in economics, and McGill University, where he also received an economics degree.

SECTOR — GENERAL INVESTING

TWST: Did you want to give an overview about the firm?

Mr. Letko: Letko Brosseau is a long-only, value-based multiproduct investment manager headquartered in Canada. We have a well-established track record, having been around since 1987, and our investment philosophy hasn't changed since. That is, we employ a fundamental, bottom-up, value approach, seeking to build portfolios with the best possible risk/reward profiles. We're looking for high-quality companies with sustainability of earnings through the cycle and good growth prospects, but at the same time we are very attentive to the price we pay.

Today we manage about $12 billion or so across several different mandates, with over $1 billion represented by our Emerging Markets Equity mandate. Our client base includes various types of institutional investors, which make up the majority of our AUM, as well as high net worth individuals.

TWST: Since the pandemic, what's been going on with a lot of the emerging markets and overseas investments in general?

Mr. Letko: First, I think the pandemic was very difficult for a lot of these markets. It caused disruption to our way of life that we had not seen before, and emerging markets were certainly not spared.

Since then, there's been a tremendous rebound, in especially the brick-and-mortar aspects of different EM marketplaces. That's been particularly beneficial to our fund, given our emphasis on companies with good current fundamentals and established competitive advantages.

In general, I think that emerging markets will continue to dependably pick up the lion's share of global economic growth. That's what helps make the space such an enticing place to invest: they're responsible for about 70% of the world's economic growth — which should continue — and yet they are only represented by about one-third of the world's equity market cap.

So there's a tremendous opportunity there in terms of emerging market equities growing into more of a leadership role globally.

TWST: Did you want to talk about different regions of the world and what's been going on?

Mr. Letko: There's obviously a lot going on. For instance, the Chinese economy is facing very well-known structural issues, from declining demographics to the general business climate to industry-specific problems such as with real estate.

And so, we often get the question: Are you bullish or bearish on China? But our view reflects a more nuanced reality. I would say we are selectively constructive.

I think it's really a stock-pickers' game and an industry-pickers' game in China. We shy away from sectors that were perhaps once dependent upon the lower cost of manufacturing, lower labor input costs, as other areas of the world have emerged as more competitive in this area.

We are more constructive on consumer-led industries and infrastructure. Industries such as health care and utilities provide basic products and services that meet the great unmet needs of the Chinese people.

In general, I think it's very dangerous to paint emerging markets and different pockets of emerging markets with the same broad brushstrokes. So in a place like China, you have to take a nuanced view. You have to do the work. You have to meet with the companies. You have to be knowledgeable about the industries that you're looking at. And that's what we bring to the table with the detailed fundamental research that we carry out.

TWST: Did you want to give examples of companies or even sectors that investors might want to look at?

Mr. Letko: Yes. So, we have a bit of an overweight position in Brazil, where we've found several hidden gems in the equity market.

One of those companies is **Sabesp** (NYSE:SBS). They're about the third largest sanitation company in the world by revenue and account for about 30% of investments in basic sanitation in Brazil. So we're talking about water treatment, sewage treatment, and similar services.

They operate as part of a regulated asset base framework where your revenues and your profits are visible over the next several years until the next rate base increase. As such, there's visibility in terms of earnings growth, providing long term upside, as well as sustainability of earnings through the cycle, providing downside protection.

Brazil has tremendously lagged behind the rest of the world in providing basic water treatment services, and so the government has made this area a major priority. A company like Sabesp will benefit from that policy thrust and thus plays a very important role in bringing what are essential services that we may take for granted in the developed world to the people of Brazil.

From an investing perspective, chances are that if you cast a very wide net and construct your portfolio from the bottom up with high-quality companies that have good growth prospects, you will naturally pick up companies that are addressing these needs — because that's where the opportunities lie. And so those are the companies investors can expect to find in our EM portfolio — companies like **Sabesp**.

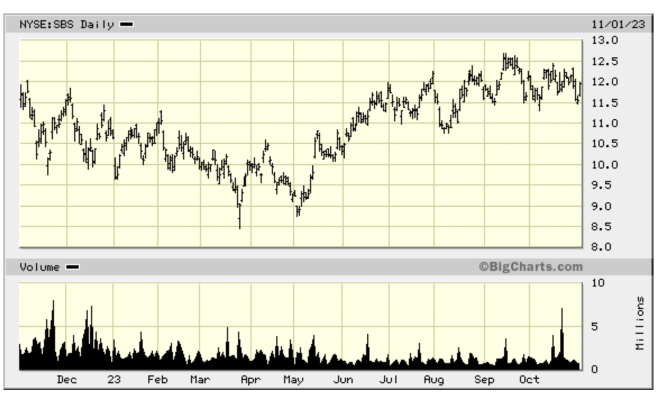
TWST: We are talking about investing in Brazil. Is Brazil a location where you're more focused on an individual company rather than the overall stock market?

Mr. Letko: Perhaps I can answer that by explaining how we generate ideas from the bottom up. Our research process at its core is a fundamental bottom-up process. We look for new ideas by running screens starting with the entire EM universe of about 6,000 public companies, and the idea is to build a well-diversified portfolio of 50-70 companies by picking those with the very best risk/reward profiles (subject to certain portfolio guardrails like maximum single position, industry and country allocations).

"Really, if you take a step back, we like to think of emerging markets as an area where there are huge unmet needs. Needs such as basic sanitation services, clean energy needs, access to affordable health care, etc. And there are companies that are working to address those unmet needs."

We think the company can grow their earnings around 18% per year between 2023 to 2027, while currently offering a 2.5% yield and trading at just 10x p/e. So this is a great example of an opportunity in emerging markets where you can purchase growth, quality, sustainability of earnings, and a good dividend for an incredibly reasonable valuation.

1-Year Daily Chart of Sabesp



Really, if you take a step back, we like to think of emerging markets as an area where there are huge unmet needs. Needs such as basic sanitation services, clean energy needs, access to affordable health care, etc. And there are companies that are working to address those unmet needs. It therefore stands to reason that given the scale of these needs, the market opportunities for these companies are enormous.

While top-down analysis is not core to our initial idea-generation process, we are certainly not agnostic to geography. We have a team of economists that carries out top-down diligence at the same time that an analyst is carrying out the bottom-up research on a given idea. For example, they run currency models, GDP forecasts, and any political/regulatory analysis that might be necessary. This allows us to make sure that macro risks are considered.

In the end, our portfolio construction will represent a diversified mix of companies, industries and geographies driven by a fundamental, bottom-up selection process.

TWST: And is that the approach you think investors in general may want to consider? To look more at individual companies but also consider macro factors?

Mr. Letko: The least I can say is that it's worked very well for us.

We have great ability in macro research, but really where our strength lies is in using that macro work to support our detailed, fundamental, bottom-up diligence on the companies. That is a true core competency that we have.

We've been able to replicate that process across not just emerging markets but other geographies as well for almost four decades. We've proven that we employ a repeatable investment process that allows our clients to make money consistently over the long term.

TWST: Is there another stock you want to highlight?

Mr. Letko: Sure. **Sinopharm** (OTCMKTS:SHTDY) is the number one drug distributor in China, with about 20% of the market. They're also the number one drug retailer. This company speaks to a large unmet need — access to high quality consumer health care products and services.

And so, in a country that probably still has ground to make up in terms of access to certain health care services, there's clearly tremendous growth potential there. That is reflected in **Sinofarm's** numbers. We think revenue and EPS can continue to grow at over 10% per year. But this is not reflected in valuation, as they pay a very strong 5% dividend and trade at around 6x p/e.

The two examples of companies that I just gave you are very representative of those that we have in the portfolio. We're looking for high-quality businesses with moats in their industries and good growth prospects. At the same time, we're value investors, so we only pay reasonable valuations for those attributes.

Because we're getting companies with exposure to growth, our portfolio has tremendous leverage to the upside over the long term. But thanks to the emphasis on high quality, sustainability of earnings through the cycle, and reasonable valuations, our portfolio also offers terrific downside protection amid periods of market volatility. This has allowed us to significantly outperform the index over a long period of time.

may even be able to benefit. In the end, you must be knowledgeable about the individual industry on a global level and you have to do the work. That is what we try to do.

TWST: Given that in some emerging economies there's not the governmental or the regulatory oversight that you'd find in an economy like Canada or the United States, are there any special precautions for people who are going out on their own looking for stocks?

Mr. Letko: I think understanding the specifics of the regulatory environments in emerging markets – and more importantly, potential changes to those environments – is extremely important.

Don't get me wrong, changes to individual regulations and laws are impossible to foresee and we don't pretend to have a particular crystal ball when it comes to that. But one thing that we try to do is understand what the priorities are of the local government, and therefore try to anticipate what are the broad secular improvements that they would like to make to society and how that will translate into strategic priorities that influence actual policy.

"Because we're getting companies with exposure to growth, our portfolio has tremendous leverage to the upside over the long term. But thanks to the emphasis on high quality, sustainability of earnings through the cycle, and reasonable valuations, our portfolio also offers terrific downside protection amid periods of market volatility."

TWST: And for a retail investor, what would be the advantage in a diverse portfolio to include some emerging market funds or just stocks in general?

Mr. Letko: I think what you're getting in emerging markets is reasonably valued exposure to growth. I think diversification is extremely important as well, and so emerging market equities provide geographic diversification for a traditional developed market investor.

TWST: There's been some push in the United States for onshoring, getting manufacturing back into the United States or maybe a country like Canada. What impact would that have on economies like in China?

Mr. Letko: That's a great question. I think that economies like China and other emerging markets are watching this very carefully. And in the end, there's no two ways about it. If there is a large push to re-onshore a certain amount of manufacturing or capacity in other types of industries, then that should negatively impact some of these emerging market geographies.

That said, I think it goes back to what I mentioned earlier, which is that it's very important not to paint these markets in broad brushstrokes. It's very important to understand at an industry and company level what is going on.

We have a team of 22 analysts which is divided across industry lines. So someone covering the retail sector in Canada will also cover the retail sectors in Brazil and China, etc. that makes our analysts experts in their domains and gives them a global perspective when assessing the impact of something like onshoring.

This allows them to see that that's something that will impact some geographies more than others, and that certain emerging markets

From there, you can identify which industries might be affected and which companies might be leaders in those industries, and then how to best take advantage.

1-Year Daily Chart of Sinopharm Group ADR

Oftentimes, the above comes back to what I mentioned earlier, which is identifying the great unmet needs of these societies. Coming back to the example of Brazil: prioritizing improvements to basic water infrastructure and the impact that has on a company like **Sabesp**.

And the other thing is I think that investing in emerging markets is difficult for some investors because they have less confidence on the ESG side.

In general, there is less transparency in emerging markets in terms of governance and environmental culpability, and so I think that impedes some investors in terms of their ability to perhaps trust that these companies are good stewards of their capital.

Therefore, it's very important to do the work on the ESG side. We hold the emerging market companies to the same standards as we do developed market companies. We have internal policies on proxy voting that each of the analysts is responsible for upholding independently, and we frequently engage with companies on these matters where necessary.

We're able to do the diligence on the ESG side because we have the analyst team in place, and because it's in our DNA; we've been doing that work for over 35 years.

TWST: Anything we haven't talked about you care to bring up?

Mr. Letko: I want to make sure that our value proposition is clear. What investors can expect from our emerging market strategy is an alpha-focused, all-cap portfolio, that's very well-diversified across 50 to 70 different names and about 15 to 20 different geographies, as well as diversified across industries as well.

The companies that investors will find in that portfolio are the companies that we have narrowed down to those offering the best risk/reward out of the entire universe of 6,000 emerging markets public equities. These are firms that offer long term upside due to high rates of growth, while at the same time offering good downside protection thanks to their high quality, low valuations and good dividends.

One can see this in our returns: since the inception of our emerging market strategy 12 years ago, the portfolio has returned 4.0% versus the MSCI EM Index at 0.8%, while it has outperformed the benchmark in every single calendar year down market (gross of fees). We've thus proven that our investment philosophy is sound and that the process is highly repeatable. Further to that point, firm-wide across our various geographic mandates, our equities have outperformed the benchmarks by over 500 basis points since inception in 1987.

TWST: Thank you. (ES)

ALEX LETKO, CFA
Partner & Portfolio Manager
Letko, Brosseau & Associates Inc.
(514) 499-1200
www.lba.ca
email: info@lba.ca