ADVERTISING SUPPLEMENT

EMERGING MARKETS

A RESILIENT OUTLOOK

IN THIS ISSUE

Allspring Global Investments
1415 Vantage Park Drive, 3rd Floor
Charlotte, NC 28203
allspringglobal.com
Susan Raynes
Head of Institutional Client Group
AllspringInstitutional@Allspringglobal.com

Altrinsic Global Advisors, LLC
8 Sound Shore Drive, 3rd Floor
Greenwich, CT 06830
altrinsic.com
Robert Job, CFA
Head of Corporate Development & Strategy
203-661-0030
rjob@altrinsic.com

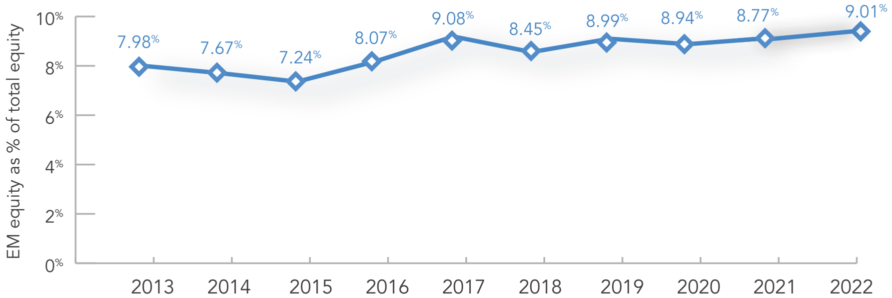
The Rohatyn Group
Park Avenue Tower, Floor 15
65 East 55th Street
New York, NY 10022
rohatyngroup.com
Harvey Felman
Head of Business Development
212-984-3519
harvey.felman@rohatyngroup.com

A WORLD OF OPPORTUNITY

Long-term allocation and active management are key to unlocking the potential in emerging markets — even amid ongoing uncertainty

A number of emerging markets have exhibited accelerated growth and are representing an increasing share of the global economy. Building on the encouraging post-pandemic trends of last year, emerging market equity performance started 2023 strong. While growth has slowed in the U.S. and Western Europe, institutional investors are encouraged by China's reopening as well as favorable structural trends in a number of Asian, Latin American and African economies, and they're taking a closer look at these markets for diversification and return.

P&I 1000: STEADY GROWTH OF EM ALLOCATIONS



Source: P&I 1000: Largest U.S. Retirement Funds, P&I Research Center; annual data through Sept. 30, 2022

> Emerging markets offer a compelling set of attributes, including diversification and alpha potential, and warrant inclusion in a broad portfolio.
> — Alice Popescu, Altrinsic Global Advisors

Valuations that had fallen dramatically in several emerging markets now look attractive, as many emerging markets forecast an economic growth premium over developed markets. Idiosyncratic political and market risks still persist, but that uncertainty can mask opportunities for a long-term diversified investor, according to asset managers who advise investors to take a selective and active approach across the emerging markets that also reduces concentration risk.

BEYOND THE INDEX

"Emerging markets offer a compelling set of attributes, including diversification and alpha potential, and warrant inclusion in a broad portfolio," said Alice Popescu, portfolio manager at Altrinsic Global Advisors. "The MSCI Emerging Markets index has struggled, but we have found compelling investment opportunities and are excited about the prospects for EM ahead," she said. Last year the index was down approximately 20% in dollar terms, but this year it's up 3.46% as of May 8.

Popescu's positive outlook is driven by four key elements: A favorable growth differential for emerging versus developed markets, China's reopening, strong domestic consumption patterns in emerging markets and attractive valuations. The valuation gap alone should attract investor attention. "Expectations for EM forward earnings growth are superior to developed markets, yet valuations are at a 35% discount," she said.

Popescu pointed out that the standard benchmark — the MSCI Emerging Markets index — is flawed and does not represent the full investment opportunity set for emerging markets. First, close to two-thirds of the benchmark reflects just three countries — China, Korea and Taiwan. Second, it is heavily weighted (27%) toward mega-cap companies — those with market capitalization above $100 billion — but these companies represent just 0.6% of the investible universe.

As an active manager, Altrinsic's portfolio allocations reflect the full DNA of emerging markets, she said. "As bottom-up stock pickers, we identify high-quality, undervalued companies that can thrive in the face of challenging macro variables."

For instance, Popescu sees opportunities in Southeast Asian countries because of supply-chain reshoring and their ability to decouple from the global economic cycle. "The growth prospects in Vietnam and other ASEAN countries are some of the best across the entire global equity spectrum. Valuations are particularly compelling," she said, referring to countries that are part of the Association of Southeast Asian Nations.

Brazil is another country with overlooked opportunities, said Popescu: "The market is overly pessimistic relative to the earnings power of many high-quality Brazilian companies. The Brazilian market is trading at one of the widest discounts relative to emerging markets over the past 10-plus years and return on equity relative to EM has steadily increased. The investment community is largely overlooking these points."

Altrinsic has identified attractive South African companies too, despite broader investor misgivings about the country over persistent power shortages, geopolitical volatility and its fiscal position. "South Africa, from a macro top-down perspective, might look unfavorable whereas from our bottom-up perspective, we have found many undervalued companies generating resilient cash flows," she said.

Investors may have broad worries about China. Popescu noted that "it will be volatile, but there are segments of opportunity." Altrinsic, in contrarian fashion, is overweight real estate in China, where it has identified companies poised to thrive, despite being underweight China overall relative to the benchmark.

Taking a long-term view and finding opportunities amid uncertainty in many ways defines emerging markets investing: "We've been EM investors for over 20 years. Geopolitical risks and controversy have always been part of our reality," Popescu said. "That said, controversy breeds opportunity."

REGIONAL VARIATION

Investing in emerging markets should be for the long term, rather than trying to time the market, said Alison Shimada, senior portfolio manager and head of the Total Emerging Markets team at Allspring Global Investments. "The key is to stay invested. This can be served not only by active management but also by having the right investment framework."

"An allocation should be considered in every portfolio because of diversification away from developed markets. EM countries are in a different cycle, particularly China versus the U.S.," Shimada said. There is also the potential for alpha: "EM has in general lower valuations than the developed markets. There's a big gap."

With a forward-looking lens, it's an exciting time for emerging markets, Shimada noted. Their economies are in many ways more stable than developed markets; for example, they have avoided the recent banking crisis in the U.S. "Central banks were quite proactive in raising interest rates ahead of developed markets, the U.S. in particular. The health of the EM banking systems has been solid, and the level of nonperforming loans quite low," she said.

Inflation has been well contained in several emerging markets. "The governments have managed inflation well in emerging markets, even if levels are elevated. Consumers are still spending money, and not recklessly," Shimada said. These developments have been guided by effective government policy. "Guidance comes from the top, and many countries are becoming more centrally governed — China, India, Brazil and Mexico. When the economy endures an economic shock, the government needs to [be able to] react."

Shimada points to the Middle East and India as favorable regions. "These are structural growth stories. Their intellectual capital is strong." Allspring has focused on companies in these regions that are poised to benefit from long-term growth, including banks.

"North Asia is more a recovery and cyclical-rebound type of story, driven by technology," she said. In contrast, external investment from China drives much of the economic activity in Thailand, Malaysia, Indonesia and the Philippines. In Latin America, many opportunities are created by reshoring from China. "Latin America is capturing investment that might have gone to China," she said.

Shimada presented an optimistic but nuanced case for investing in China. "We're constructive on China, but selective. You have to go stock by stock." She noted this requires experience and a deep understanding of government policy. As opposed to trend-following investment strategies, which have been successful historically, an individual stock-picking approach is needed today. Allspring has focused on companies that can benefit from government policies, such as electric vehicle production. "We try to align ourselves with government policy and those economic sectors that policymakers are emphasizing."

For investors who may be wary of China due to its recent regulatory crackdown, Shimada cautioned against ignoring the country. "China is one of the fastest-growing economies within emerging markets and possibly globally," she said, which underscores its importance for global investors.

MULTIFACETED EXPOSURE

"There are three major reasons why a global allocator wants exposure to emerging markets," said Dalibor Eterovic, managing director and member of the Fixed Income and Currencies investment team at The Rohatyn Group.

The first is diversification. "Large, liquid emerging market countries provide exposure to different risk factors from the developed world, such as demographics, natural resources, expanding middle classes and industrialization," he said.

The second reason Eterovic pointed to was idiosyncratic upside possibilities in smaller, less liquid countries. "For example, within the [JPMorgan] Emerging Market Bond index, there are 11 sovereigns trading at prices below 60 cents on the dollar. With the right set of policies by each government, each could present an attractive opportunity," he said.

Finally, there is the sheer size of emerging market economies. When taken together, "they represent more than half of global GDP and 70% of growth in the global economy. We believe this is too large not to be reflected in a global portfolio," he said.

In his current global macro outlook, Eterovic sees several favorable conditions for emerging market countries. "We see more balanced global growth. U.S. economic activity might be softer but it will be offset by stronger growth in China. The recovering economy in the Eurozone traditionally has favored emerging market financial assets," Eterovic said. Divergence in interest rates between the U.S. and emerging markets, where rates are often higher, is another area of opportunity.

China's recovery increasingly tilts global growth in favor of emerging markets relative to the U.S., said Luis Arcentales, managing director and member of the Office of the CIO at The Rohatyn Group. "China's rapid reopening offers cyclical opportunities, but selectivity is important, given the unique nature of the ongoing recovery." China's previous recoveries were led by infrastructure or real estate, and this cycle is consumer driven. "It will have lower global spillovers, and the bulk of the benefits will be Asia-centric," he said.

SUSTAINABLE LENS

While ESG investing is commonplace in developed markets, ESG awareness has been slower to build among companies and issuers across the emerging markets. Yet with many emerging markets countries more exposed to extreme climate disasters and other environmental risks, as well as ongoing corporate governance risks in these regions, investors are increasingly applying an ESG lens in investment decisions.

THE VALUE OF ENGAGEMENT

Allspring uses an ESG-integrated approach and conducts its own independent analysis of these aspects. "We do qualitative research on the social and corporate governance of each company, and we quantify the 'E' factor by calculating its equity value-at-risk," Shimada said. It can be costly for companies to comply with environmental regulations, and thus analysis is particularly important for equity purchases, she said.

Allspring takes an active-engagement approach with corporate management on ESG issues. "Active engagement is the best way of reminding them that we care about these things and of effecting change," Shimada said. For instance, on measuring their net-zero commitments, "we always ask, 'What are their targets?' and 'What is the progress?'"

MATERIALITY MATTERS

Since Altrinsic's inception in 2000, "ESG has been embedded within our fundamental research process," said Popescu. "Materiality of ESG factors is the key consideration in our process," determined through a combination of internal analyses and third-party data sources, she noted.

"First, we identify the material issue. Second, we analyze the issue and evaluate any positive or negative implications. Third, we engage with the company's senior management on that particular issue. And fourth, we assess the impact of that issue on company fundamentals," Popescu explained. Governance is an innate risk consideration in emerging markets and one on which the asset manager has long maintained a strong focus.

A FLEXIBLE FRAMEWORK

Active management for emerging market exposure is a must — but which strategy?

The rationale for investing in emerging markets is less "why" and more "how." With numerous regions, sectors and assets to consider and invest in using different strategies, today's successful emerging markets managers tend to pursue an active investment approach — each enhanced by their proprietary framework. Environmental, social and governance investing is a consideration as well. The passive approach tends not to translate well for the emerging markets, as the indexes do not accurately reflect market capitalizations or provide the flexibility needed to manage market volatility.

PUBLIC MARKETS

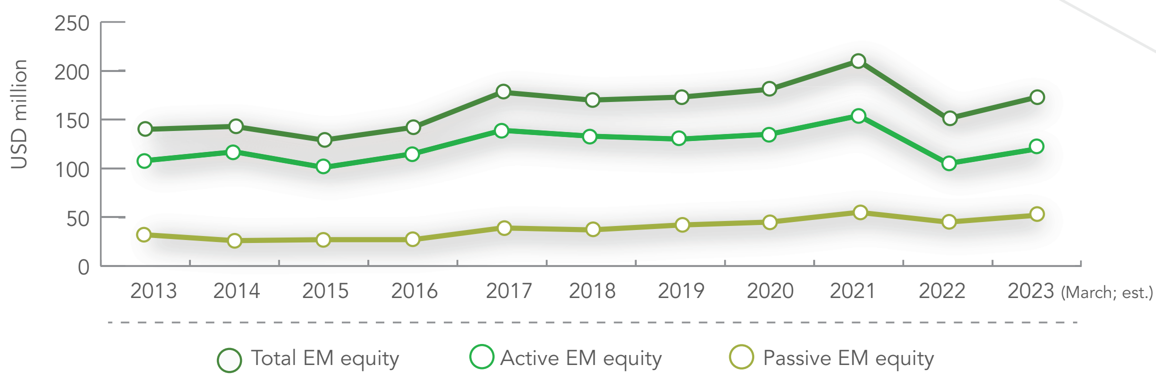
"We are active managers. EM investing doesn't lend itself to passive vehicles because you have to make very difficult decisions in short order, whether it's getting back into China after the Party Congress in November or getting out of Russia" after the breakout of the Ukraine war, said Shimada at Allspring.

Public investments hold many advantages over private investments in emerging markets, said Shimada. "Unlisted, or private, equities are very difficult to monitor. An important aspect of investing in EM is also exiting at the right time. The flow of information is better in the public equity market." She also noted that public equities are more liquid, which is a particular concern for investors in emerging markets investing.

Having a strong framework is critical to being a successful and differentiated active manager. "The framework that we use is a total-return approach incorporating multiple re-rating, earnings growth and shareholder yield. The objective of our primary strategy is to select largely local equities and to have a shareholder yield greater than the index at the time of purchase," Shimada said. The framework is designed to provide both growth and income from dividends, buybacks and spinoffs.

> "The key is to stay invested. This can be served not only by active management but also by having the right investment framework.
>
> — Alison Shimada, Allspring Global Investments

P&I 1000: EMERGING MARKET EQUITY ALLOCATION



Source: P&I 1000: Largest U.S. Retirement Funds, P&I Research Center and Bloomberg LP. Annual data as of Sep. 30, 2022; March 31, 2023 data reflects investment performance, not new asset inflows, based on the MSCI EM index.

Shimada said that attempting market timing is a mistake. "The point of running a strategy should be to have a framework that keeps you in the market versus trying to time it."

SHIFTING OPPORTUNITY AND RISK

"Active management anchors the way we think about investments. We don't view the emerging market space as a monolith," said Arcentales at The Rohatyn Group. "Valuation is one of the many tools that go into our investment analysis, in addition to assessing the global and domestic business cycles and idiosyncratic factors like policy actions," he explained.

Valuation is important, but it's not always a sufficient reason to make an investment, he said. For instance, wider macro and market trends, beyond only valuations, need to also support emerging markets investing. Current tailwinds include widening growth differentials, the scope for rate cuts as inflation eases, as well as China's rebound and the inflection lower in the dollar.

"This environment is good for carry at the short end of the curve due to divergences in monetary policy in emerging markets," said Eterovic. Many emerging market countries have interest rates in the double digits, much higher than developed markets, he said. "That differential can be exploited as a carry trade." [See chart below.]

Arcentales also highlighted dollar-denominated corporate bonds as an area for generating yield but without exposure to currency risk. "These are showing a significant premium compared to their U.S. counterparts," he said.

MULTIPOLAR WORLD ORDER

Yet even as emerging markets present several opportunities for investors, they need to stay vigilant about potential risks. "The past year has served as a reminder of how shocks can quickly expose vulnerabilities in both emerging and developed markets," Arcentales said. "A higher geopolitical risk premium is warranted from the ongoing shift to a multipolar world order. This is creating both risk and opportunities for emerging market investors."

The risks aren't just higher, but also different in today's shifting geopolitical landscape. For example, "China is now a major bilateral creditor for many small countries that have run into trouble, a shift from past debt workouts led solely by Western institutions. China and Western creditors are struggling to reach consensus on a range of issues, preventing restructurings from moving forward," he explained. "It is very costly for investors, for countries and their populations. It's an area which should be monitored closely."

But geopolitics also brings opportunities, such as the friend-shoring of U.S. supply chains. Many companies have switched to suppliers based in countries that have better relations with the U.S. than China. "Some countries are benefiting from supply chain diversification," said Arcentales. These include India, Mexico, Vietnam and other countries in Asia. "There's a larger pie to share for countries that can position themselves as a cost-effective and reliable alternative to China in this geopolitically tense environment."

As China and the U.S. compete, ultimately it is the emerging markets that could prove to be economic winners. "Some of these countries can extract concessions, whether that be preferential trade terms or subsidized loans. They can benefit from geopolitical tensions as the two large powers compete for influence," Arcentales said.

DEFINING ACTIVE MANAGEMENT

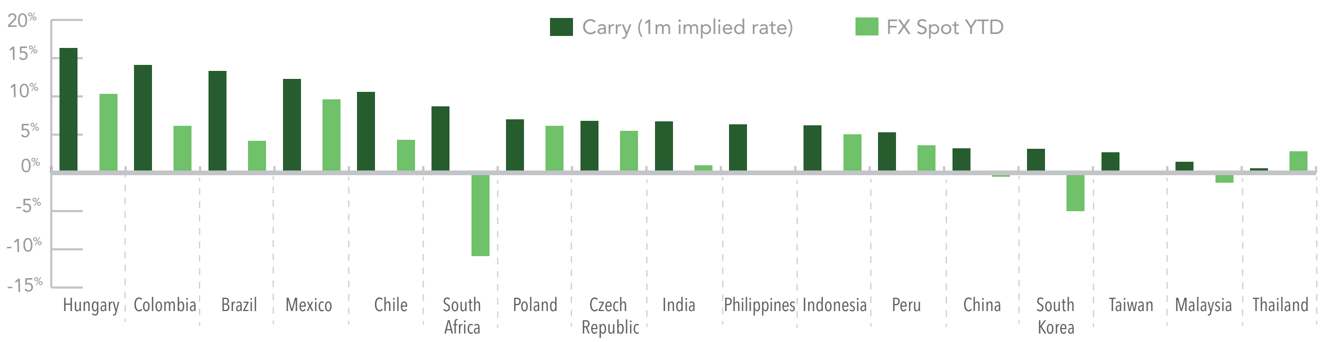
"Active EM investment strategies vary widely," said Popescu at Altrinsic. Though the firm sees listed equities as the most appropriate way to gain exposure to the asset class, investors should be mindful of the potential pitfalls — crowding in the largest stocks, liquidity concerns and the limited nimbleness of large asset managers.

Therefore, when considering emerging market allocations, "asset owners should assess whether they are buying an actively managed product that largely reflects an increasingly flawed benchmark or an actively managed strategy designed to identify and capitalize on underappreciated, unique, differentiated investments," she said.

Altrinsic's bottom-up, intrinsic-value investment process generates a portfolio of differentiated EM holdings, Popescu said. Attributes include a quality focus — as defined by demonstrated cash flow returns — a mid-cap orientation, consideration of liquidity, true diversification by country and sector, and direct exposure to frontier markets.

"Our experience over the past two decades has shown that mid-cap companies represent the DNA of the EM asset class and, accordingly, warrant inclusion into a differentiated EM portfolio," as do certain frontier countries like Vietnam, she said.

FX CARRY AND SPOT RETURN



Source: Bloomberg, as of May 11, 2023.

SEIZE THE MOMENT

Investing in emerging markets has never looked more attractive — but with the right manager

Asset owners looking to avail themselves of the considerable opportunities across emerging markets — albeit with an appropriate risk-reward lens — should consider working with asset managers who have distinct capabilities. Investor concerns about inherent risks in these markets can be addressed by managers who have a deep understanding of the potential effects of macroeconomic outlooks, geopolitical and idiosyncratic risks, and business dynamics at regional and local levels.

GLOBAL AND LOCAL VIEW

Both global and local macroeconomic factors are critical to success in investing in emerging markets, said Eterovic at The Rohatyn Group. "We put significant effort into the analysis of global and local determinants in our investment process. We aim to be a global emerging market manager, but with local knowledge and extensive local reach."

Emerging market managers "need to have a very detailed and focused approach to understand the idiosyncrasies of the different countries," he said. Eterovic's colleague Arcentales added, "We combine analysis of U.S. monetary policy or China with local knowledge, gained both from our experience and through our vast portfolio of companies on the ground."

UNLOCKING VALUE

When considering emerging markets, investors may overlook key aspects of managers' strategies that determine their ability — or lack thereof — to unlock value, said Popescu at Altrinsic. Following the benchmark, which is concentrated by country and market cap, too closely and ignoring frontier markets are just two examples.

Focused, nimble and experienced asset managers in the emerging markets are able to deliver long-term value to clients, she said. "We look for companies across the full market-cap spectrum and across all emerging and frontier countries that are delivering sustainable financial productivity and are undervalued by the market," Popescu said.

Two key factors are setting up an attractive outlook for emerging markets in the short to medium term, Popescu noted. "First, valuations are deeply discounted, but we are expecting a significantly improved growth profile for emerging markets versus developed markets. Second, we believe there's a truly underappreciated recovery in financial productivity underway when looking at cash flow returns," she said.

"The opportunity set is exciting. Emerging markets outside of China are finally breaking out. Demographic shifts, internal demand drivers, innovation, and evolving supply chains and trade agreements are creating large pockets of underappreciated value," said Popescu. "Our bottom-up approach, culture of diverse perspectives, thoughtfully curated networks, deep knowledge of the asset class and contrarian nature give us the ability to approach the EM asset class differently than our peers."

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>
> — Dalibor Eterovic,
> The Rohatyn Group

AN INNOVATIVE MINDSET

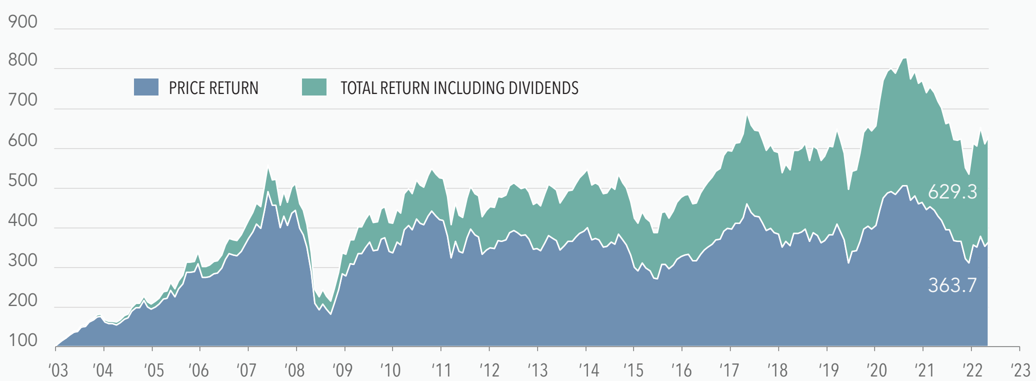
In the past, asset owners had primarily focused on growth managers in emerging markets, but that approach may no longer deliver the consistent returns that they seek. "The last 10 years had zero interest rates. Today, the cost of doing business has gone up. Investment success depends on resilient businesses, whether growth or value," said Shimada at Allspring.

Allspring's framework focuses on stocks that have a sustainable dividend yield and strong fundamentals coupled with an ESG approach. "We apply a slightly value-tilted strategy, incorporating the positive characteristics of shareholder returns," said Shimada. This framework has led to sustainability and resiliency in performance, in contrast to market timing. "It's not a common approach," she said, and it requires a consistent focus on quality and returns. [See chart on emerging market dividend yields.]

When it comes to choosing an emerging markets manager, experience is ultimately key. Asset owners should "look for a long-term track record of sustained performance, and an investment team with experience," Shimada said.

DIVIDENDS ARE A SIGNIFICANT PORTION OF EMERGING MARKETS TOTAL RETURN

MSCI EM (GD) RETURN DECOMPOSITION



Source: Bloomberg, as of March each year; USD.