Equity Asset Allocation: Global Emerging Markets

Q2 2020

Description: At Milltrust, we have developed proprietary **geographical asset allocation models** that help drive the country allocation recommendations for our equity investment solutions. The models are based on a scoring mechanism that compares and evaluates the attractiveness of each country using quantitative investment factors that have been shown to convey information about future equity returns. This allows us to tilt the portfolios towards the countries and regions that provide a more favourable environment with the goal of enhancing dollar returns of unhedged global equity portfolios. This is a systematic process.

Strategy: Milltrust Global Emerging Markets Equity Strategy

Investment Universe (core – 11 countries): China, Taiwan, India, South Korea, Thailand, Malaysia, Indonesia, Brazil, Russia, South Africa and Saudi Arabia.

Summary: In absolute terms, we are currently in an environment where nearly every country in this specific investment universe (defined above) has had a downgrade over the last 6 months in their GDP growth forecasts for 2020, where nearly every country's forecasted price-to-earnings ratio is trading below their 10 year average, where nearly every country's year-on-year price momentum is negative, and where nearly every country's short term interest rates have declined relative to their 24-month average. These are clearly unique times. However, when doing a relative comparison between the different countries, which is the basis of our models, there are some clear 'overweights' and 'underweights' within this universe. We tend to favour the east Asian markets of Taiwan and South Korea alongside Russia and Brazil. Interestingly, China has now fallen into the underweight category mainly due to the other countries becoming cheaper and providing more accommodative monetary policy to support markets; the Chinese markets have been remarkably resilient during Q1.

Highlights:

- **Overweight:** Russia, South Korea, Taiwan, Brazil

Russia remains the top ranked country in our model with the double benefit of offering attractive valuations and high dividends; the year-on-year price momentum is also still positive. South Korea is another overweight and has been resilient from a growth perspective with growth forecasts for 2021 remaining unchanged over the last six months; it also has an inexpensive equity market and an undervalued real exchange rate. Meanwhile, Taiwan's attractiveness is boosted by their favourable risk indicators including substantial current account surpluses relative to GDP. Finally, Brazil offers fairly-priced markets and a significantly undervalued real exchange rate.

- **Neutral:** Indonesia, South Africa, Malaysia

Valuations are relatively attractive in Indonesia but the country faces headwinds from its overvalued real exchange rate, current account deficit and widening sovereign spreads. Meanwhile, Malaysia has seen its growth forecasts come down for both 2020 and 2021, a significant widening in sovereign spreads and more negative year-on-year price momentum than the peer group. Finally, South Africa moves up from being an underweight to a more neutral position due to the valuations now being well below both their 10-year average and the Emerging Market average; although tight monetary conditions and poor risk indicators remain a concern.

- **Underweight:** Saudi Arabia, Thailand, China, India

India might now be finally offering attractive valuations versus its long-term average but negative price momentum and significant recent downgrades in the 2020 and 2021 growth forecasts point to a value trap. Interestingly, China falls from neural to underweight mainly due to the other countries becoming cheaper and providing more accommodative monetary policy to support markets; the growth forecasts for 2020 have also fallen significantly and the country's risk indicators continue to be negative with high excess credit growth and a current account deficit. As expected, following the big drop in oil price, Saudi Arabia faces negatively trending terms of trade in a market that is already more expensive than the EM average. Finally, Thailand scores poorly in growth, valuation and sentiment indicators making it a big underweight.

Scorecard:

Ranked from most attractive to least attractive.

Factors	Growth	Valuation	Sentiment	Policy	External	Risk	Score
Russia	10.03%	13.04%	17.03%	1.11%	-13.48%	0.33%	6.59%
Korea	7.11%	-2.38%	0.32%	0.60%	9.04%	2.06%	2.54%
Taiwan	3.56%	-3.46%	13.37%	2.00%	0.11%	7.00%	2.28%
Brazil	-3.66%	1.84%	-3.05%	2.88%	11.72%	-1.43%	0.91%
Indonesia	3.27%	3.92%	-7.86%	5.05%	-4.47%	-6.83%	0.30%
South Africa	-11.16%	11.45%	-1.42%	-3.97%	1.54%	-3.93%	-0.19%
Malaysia	0.31%	-4.74%	3.80%	1.64%	3.04%	1.25%	-0.26%
India	-5.80%	1.47%	-9.96%	0.32%	-0.31%	-4.08%	-2.52%
Saudi Arabia	3.08%	-9.20%	-3.75%	-4.59%	-5.65%	6.33%	-2.74%
China	-1.01%	-7.04%	1.45%	-4.87%	1.02%	-3.97%	-3.07%
Thailand	-5.72%	-4.90%	-9.92%	-0.15%	-2.55%	3.26%	-3.82%