

Q4 2024 - Emerging Markets Quarterly Update

Portfolio Manager Akhil Subramanian provides an update on the fourth quarter for our Emerging Markets Value strategies.

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Hi, I'm Akhil Subramanian. I'm a portfolio manager here at Pzena on our Emerging Markets team, and I'm here to give you an update about the fourth quarter of 2024. EM had a challenging Q4. The issues that came up were, number one, in the US: elections and then uncertainty over the new administration and what consequences that has for trade, tariffs, foreign policy. And then in certain EM markets, some countries dealt with issues closer to home that posed various uncertainties. For example, in Brazil there are concerns around the fiscal situation and the government's budget to spend, and then in South Korea the former president tried to enact martial law in the fourth quarter and is currently in the process of being impeached. So it was an environment where there was a lot of fear and a lot of uncertainty, and valuations in EM certainly came in. The MSCI EM index was down 8%, and the value index was down about 9%. Our strategy underperformed both of those modestly and was down about 10%.

In terms of contributors in the quarter, two of our contributors were UIS and TSMC, which both continued to benefit from the story around AI, and at TSMC widening the gap between a couple of its competitors—one of whom had difficulties in Q4. The other contributor was Abu Dhabi Commercial Bank, a well-run bank that continued to have strong earnings in the quarter.

In terms of detractors, two of our detractors were Alibaba and China Overseas Land & Investment. Unsurprisingly, they were contributors in the previous quarter, given the timing around China stimulus. The China stimulus announcements happened toward the end of September, which benefited COLI and Alibaba, and then the lack of follow-through in the fourth quarter led to Alibaba and COLI basically being underperformers. We continue to like both businesses. We think that Alibaba continues to invest to gain market share back in e-commerce, and COLI is doing a pretty good job of navigating some pretty challenged fundamentals in the China real estate sector.

The third detractor in the quarter was Samsung. Samsung continues to have issues around, number one, the memory cycle—which continues to be in a downturn for things such as smartphones and PCs—and then secondly, there have been a lot of delays in Samsung getting qualified for high-bandwidth memory, or HBM. But we're optimistic that the company's on the path to getting qualified and becoming a second supplier to the likes of Nvidia, and we're encouraged by the fact that the management team at Samsung enacted a buyback in the fourth quarter, so they are looking to take advantage of a pretty depressed stock price.

In terms of activity that we did, we bought two new businesses in the fourth quarter. The fourth quarter coincided with a period where the oil price started to fall, and so as a result, Saudi Aramco, which is one of the largest oil companies in the world, came into the cheapest quintile, and we added that to our portfolio. Aramco has one of the lowest-cost resource bases around the world; for example, Aramco made money during 2020 when the oil price was very low. Also, it

has a very clear capital allocation policy and a very professional management team that is focused on maximizing the value of the resources they have. We're excited to own this business. It's an example of a very high-quality franchise that's at a very attractive valuation for us.

The second business we bought is a little bit more idiosyncratic. We bought a Korean company called Orion, which is spelled O-R-I-O-N. This company makes snacks—things like chips, chocolate, confectionaries. What happened was toward the beginning of 2024, Orion announced that it was going to spend the equivalent of one year's cash flow to invest in a biotech business in Korea called Liacam. So Orion bought a 25% stake approximately in this business, and the stock sold off when that news was announced because of concerns around capital allocation. We spent some time both with Orion and with the company they invested in, Liacam, and I think what we have learned is that this transaction was a one-off. Management at Orion—their goal is to deploy capital in three ways: one is organic growth into the business, where they continue to get market share gains in Korea; number two, shareholder return via dividends; and number three, if they pursue M&A, it will be within the core competencies of the business, which is the snack industry or the food and beverage industry more broadly. So they believe this transaction was a one-off. We give no credit to this company Liacam in our valuation, and we also penalize the Orion management team for future capital allocation, basically assumed that they will invest in things that yield very low returns. And even on that basis, Orion ended up being in the cheapest quintile, which is basically our criteria for looking at and investing in a business. So after projecting forward the business and calculating normalized earnings, penalizing the business for bad capital allocation, and ascribing no value to Liacam—which they invested in—Orion was still in the cheapest quintile and therefore a company that we added to our portfolio.

Interestingly, Liacam, since the announcement of Orion's 26% stake—Liacam is still publicly traded—the stock price of Liacam has doubled. I think this is what excites us about emerging markets. We have a very big universe of 1,500 companies to choose from. They are in different sectors, they are in different countries, some of them come up with very, very interesting idiosyncratic issues, and for investors like us who love to do the bottom-up fundamental work, if we can find businesses that are trading at a low multiple of normalized or mid-cycle earnings, there really is a strong case for active management in EM, just as evidenced by us being able to acquire a company such as Orion.

So that's what happened in the fourth quarter. It was a very challenging quarter, but we continue to be excited by a portfolio that has various businesses across EM that are trading at attractive valuations of their normalized earnings power. We look forward to giving you an update in Q1 shortly. Thank you.

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