

At Pzena, we're often asked why you would use a value approach in emerging markets, and it's a great question because it's not very intuitive to people. You think you're going to the emerging markets for growth, so why would you invest using a value approach? That's exactly why it works so well, by the way.

So when we were first launching this strategy, we looked into this as well, what has historically worked well in emerging markets? Because certainly the common wisdom is, emerging markets are all about growth, they're all about picking the right countries, etc. What we found was actually quite contrary to that. In fact, there is no reliable correlation between GDP growth and stock price performance, that's true in emerging markets and the rest of the world. The problem is, it all gets priced in.

What has worked well in investing in emerging markets historically is investing using one of two approaches, either a momentum-based approach or a valuation-based approach. And in fact, value has worked even better in emerging than in developed markets historically. Why is that? That was our question as well, so we dug into it, and what we found is that valuation spreads tend to be wider in emerging markets. And that's exactly why the value cycle works anywhere, right? In times of fear, people want to feel safe, so they sell things that seem controversial or more risky, and that's when value spreads widen out. Then move down the road a little bit, maybe we're feeling a bit better about the direction of economic growth and company profitability, we want to take on a bit more risk in order to have a bit more reward in our portfolios, and so we move back into those stocks, and that's when the valuation spreads tighten up. That is the value cycle, those spreads widening out and then tightening up.

And if you think about it, that sort of psychological feeling of fear and then of euphoria is heightened in emerging markets, because they're more far-flung, they're less well understood, you are more likely to flee from them in times of fear and rush back into them in times of excitement. And so that value cycle has been even more pronounced in emerging markets, and we expect that that is something that has helped our portfolio over time as well. So it's not intuitive, there are not very many people out there using a value investing approach in emerging markets, but we're pretty confident that it's a great way to go about it here at Pzena.

Thank you.