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News Release

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Emerging Market Equities Attracting More U.S. Investors

Higher Future Economic Growth Prospects Compared to Developed World, Lower Risks and Quality Managements Give EM Stocks Appeal

Edinburgh, Scotland– 12 July 2017 – Equity markets in the U.S. are at or near all-time highs, but with the International Monetary Fund forecasting developed country gross domestic product (GDP) growth of only 1.7 percent through 2022, investors may want to consider other markets.

Emerging market GDP is projected to grow 4.5 percent in 2017 – and 5 percent by 2022. This will create significant growth opportunities for global investors. It will also bring challenges to identify the best in class among far-flung, often obscure emerging markets (EM).

“This is an excellent time for U.S. investors to allocate to EM equities,” explained Kim Catechis, Head of Global Emerging Markets at Legg Mason-affiliate Martin Currie, based in Edinburgh, Scotland. “Price-to-book and return-on-equity ratios are favorable. Emerging markets are cheap, relative to the developed world. However, it is unsustainable to expect EM asset classes that return better profitability measures than developed nations to continue being so much cheaper.”

This has created urgency in seizing EM opportunities, as well as pitfalls, Mr. Catechis observed.

“The dispersion of returns over the last 10 years, based on MSCI stocks, has been 30 percent,” he said. “That's measuring the range between the fifth and 95th percentiles. It means that, if you take a passive approach and just buy an exchange trade fund (ETF), you must buy the good with the bad. You are really not getting a satisfactory focus on the better parts of the asset class.”

Issues investing in EMs start with the 24 countries in the MSCI Emerging Markets Index.

“These are countries of different sizes, growing in different directions, at different speeds.” Mr. Catechis said. “It is a very heterogeneous asset class, full of risks: political, reputational, human capital, environmental, legislative. The MSCI now has 830 stocks, but we consider ourselves to be working with a universe of approximately 1,000, including Frontier and off-index names.”

The Martin Currie EM team analyzes all 24 countries and nearly 1,000 companies to weed out poor performers. The GDP of six EM nations is projected to grow 4.8 percent or more:

- India (8.2 percent)
- Philippines (7.0)
- Vietnam (6.2)
- China (5.7)
- Indonesia (5.5)

- Malaysia (4.8)

These are among the top targets for the Martin Currie EM team, and within them some stand out. “We like China,” Mr. Catechis said. “The new, shiny, technology-based companies have high returns-on-equity, zero debt, great growth and brilliant monetization and cash flow generation possibilities.”

As for countries they may choose to avoid, five are projected at 2.5 percent GDP growth or less:

- Greece (1.0 percent)
- Russia (1.5)
- Brazil (2.0)
- South Africa (2.2)
- Taiwan (2.5)

Within these nations, however, Martin Currie expects that some investments may outperform. “Greece has two or three really good quality companies,” Mr. Catechis noted. “Some of the best environmental regulations in the world are in Brazil, which actually helps extractive industries.

Russia does not show the same concern for the environment, but they show significant concern for workers' rights protection, welfare, and social considerations. Business cultures vary, a lot.”

“Even within broadly difficult economic situations, there will always be companies that exceed expectations,” he said. “The challenge is identifying and keeping tabs on them. EMs are not best accessed through passive, index-hugging vehicles. We recommend that savvy global investors should seek out EM mutual funds and ETFs run by experienced specialist active managers.”

This reliance on established companies can cause Martin Currie to miss the latest high-flyers.

“We have difficulty investing in companies with very short track records, and in emergent, fragmented industries,” Mr. Catechis admitted. “We are unlikely to be early adopters, early buyers of untested business models. We put great store by company management track records.”

Reaching conclusions on which EM countries, sectors and names to invest is a guided process.

“Essentially, there are three distinct characteristics to our investment process,” Mr. Catechis explained. “We are highly experienced specialists in EMs and have worked together for more than 10 years, unusual characteristics to our team. Next, the portfolios we assemble are at similar valuations to the index, in terms of price/earnings or enterprise value to EBITDA. For the same price we get significant premiums on return on equity. Because return on equity is a function of capital structure, we have stronger, more conservative balance sheets in our portfolios. There is a big differential in the companies we own.”

“Lastly, we look for growth – like everybody else – but we want higher, sustainable growth into the future. We also get, for the same characteristics, significant minimum growth over the index.”

“Our other big differentiator is a full and pragmatic environmental, social and corporate governance (ESG) assessment,” Mr. Catechis said. “Our investment horizon is typically three to five years, very low turnover, last year closer to 20 percent. We focus on 40 to 45 names on average and ESG is very important to our process. It helps us identify best in class companies.”

Martin Currie uses this process to find higher growth, sustainable growth, at a reasonable price. “We want the best quality management, with the best quality balance sheets in the best situations we can find,” Mr. Catechis said. “We like natural economic moats around the businesses and sustainable cash flow growth over time. That can make for a pretty compelling proposition.”

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About Martin Currie
Martin Currie is an active equity specialist, driven by investment expertise and focused on managing money for a wide range of global clients. Its approach to investing is simple: it focuses on companies. The integrated investment floor seeks out those companies it believes have the fundamentals to deliver material outperformance on a medium to long-term basis. Once identified, these ideas are molded into well-balanced portfolios. The firm's approach to portfolio construction reduces and controls macro-factor sensitivity, aiming for client portfolios to derive maximum value from stock insights and for returns to be delivered in a predictable and sustainable fashion.

Martin Currie is an independent investment affiliate of Legg Mason, a global asset management firm with over US$19.5 billion in assets under management as of 30 June 2017. Legg Mason provides active asset management in many major investment centers throughout the world. The firm is headquartered in Baltimore, Maryland, and its common stock is listed on the New York Stock Exchange (symbol: LM).

About Legg Mason
Legg Mason is a global asset management firm with $727 billion in assets under management as of May 31, 2017. The company provides active asset management in many major investment centers throughout the world. Legg Mason is headquartered in Baltimore, Maryland, and its common stock is listed on the New York Stock Exchange (symbol: LM).

EBITDA stands for earnings before interest, taxes, depreciation and amortization. EBITDA is one indicator of a company's financial performance and is used as a proxy for the earning potential of a business, although doing so has its drawbacks. Further, EBITDA strips out the cost of debt capital and its tax effects by adding back interest and taxes to earnings.

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