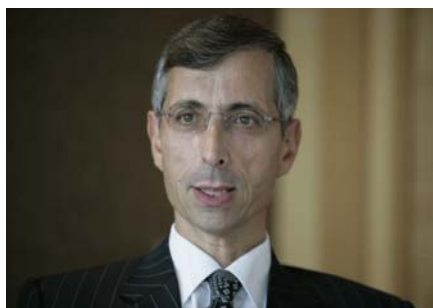


# Schroders Talking Point

## Global Emerging Markets



### Biography

Allan joined Schroders in October 2004 as Head of Emerging Market Equities. He is a Fellow of the Securities Institute (FSI), Member of the Institute of Chartered Accountants (ACA) and has a BA (Hons) Degree in Economics from York University. His investment career began in 1980 and he has worked at companies including LGT Asset Management (where he was Head of Global Emerging Markets) and WestLB Asset Management (where he was Head of Global Emerging Markets and later Chief Executive Officer of WestAM (UK) Ltd).

The case for investing in emerging markets is compelling. These countries are generally in much better financial shape than the developed world and offer outstanding long-term growth potential. Allan Conway, Head of Emerging Market Equities, talks about what the future holds for emerging markets.

### Does the recent rally have further to go?

Emerging equity markets have rallied strongly on the back of improved risk appetite, with the huge injection of liquidity we have seen in the wake of quantitative easing feeding through into asset prices. Following a very difficult 2008 for emerging markets, which underperformed developed markets due to heightened risk aversion and profit-taking, they have outperformed in the market rally, rising by 20.1% in the year to 31 May 2009. The run-up in markets is signalling optimism among some investors that we are seeing signs of economic recovery. Although recent data indicates that the global banking system has probably stabilised, the level of uncertainty about the length and depth of the global economic slowdown nevertheless remains high and in our view there is potential for further near-term market volatility.

However, we would view any setback as a buying opportunity and once there is firm evidence of economic recovery (even if the recovery is relatively subdued) we would expect to see very strong returns from emerging markets.

### So you believe that the near-term outlook for these markets is better than for developed markets?

Yes, despite the perception that these markets are 'high risk' the emerging economies are generally in much better shape than the developed world, with more room for fiscal spending to be used to counteract any slowdown. Debt levels in emerging markets are also generally modest and they will not be held back by the painful process of deleveraging that looms for many of the industrialised countries. We therefore expect the emerging economies to lead the global recovery.

### What about the longer term?

The key reason for investing in emerging markets is to get access to the premium rates of economic growth in these countries. A long-term secular trend is unfolding, with the centre of gravity of the global economy shifting from the developed to the emerging world – the emerging economies are now the drivers of global growth. In recent years, the emerging economies have been growing 4% to 5% faster than the developed economies and this is expected to continue for the foreseeable future. They have also accounted for a significant proportion of global growth in recent years and, in 2009, the only growth we are likely to get in the global economy is set to come from emerging markets.

### Where are you finding the best opportunities?

At present, our favoured markets include China, where supportive monetary and fiscal policy is leading to improving economic growth and valuations are at reasonable levels. We are finding some good value in Russia, which is also benefiting from higher oil prices. We also have an off-benchmark position in Qatar, one of the fastest growing economies in the world, where we have identified strong stock-specific potential. Our largest under-weights are in those markets that are more exposed to the developed world – Mexico, where the economic outlook is poor due largely to its sensitivity to the US; and Korea and Taiwan, where the linkage to the developed world is largely through technology exports. In addition, valuations in Taiwan are looking expensive, while Korea's economy is over-leveraged.

### Why are the prospects for the BRIC markets particularly strong?

BRIC countries (Brazil, Russia, India and China) account for over 40% of the world's population and are projected to account for over 70% of global GDP growth by 2040. They are seeing very strong consumption growth, particularly the huge markets of China and India, fuelled by a burgeoning middle class as these countries industrialise. Indeed, despite the global recession, China and India are expected to continue to see strong growth this year. Overall, consumption growth in the BRIC economies is now more important to the global economy than that in the US and we believe this is going to be the case for the foreseeable future.



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### How can investors access emerging markets?

The **Schroder Global Emerging Markets Fund** provides diversified exposure to global emerging markets. The Fund has a strong performance track record, having outperformed its benchmark over one, three years and since inception (October 2006) and aims to achieve 50% of its value added from our country allocation strategy and 50% from stock selection. Overall, our robust investment process has enabled the Fund to achieve strong returns with relatively low levels of risk.

### Can you describe your investment process?

Schroders has a balanced approach to investing in emerging markets. We use a mix of top-down analysis and bottom-up stock selection, looking to derive added value from both country allocation and stock selection. Our core investment process does not target any particular style bias and aims to outperform in most market environments.

### Country selection

We believe that selecting the right countries to invest in within the emerging markets universe is a key decision. We use a proprietary quantitative model to drive country allocation. The model uses five groups of factors, which are scored to produce a ranking of countries across the global emerging market universe. The output of the model is reviewed at the monthly strategy meeting to determine if there are any reasons not to follow its recommendations. This judgmental overlay is based on three groups of quantifiable factors (equity, macro and sector) and other non-quantifiable factors (politics, for example).

### Stock selection

We do not believe quantitative tools can replace a good, well incentivised analyst conducting fundamental research in generating successful stock ideas. The primary research universe consists of all stocks in the MSCI Emerging Markets Index, although we also aim to find good investments from the wider emerging market universe. Our team of 23 emerging markets analysts is located in eight offices. Through their extensive programme of company visits, we evaluate a company’s management team, obtain key inputs for earnings models, assess the company’s strategy and review their operations.

### Portfolio construction

At the country level, allocation decisions are driven by the quantitative model suggestions with controlled judgmental overlay from the team. The monthly strategy meeting is attended by all members of the emerging markets team and the whole team contributes to the discussion on countries. However, the final allocation decision is owned by five key investment professionals: Allan Conway, Head of Emerging Market Equities, the three global fund managers (Robert Davy, Waj Hashmi and James Gotto) and Nicholas Field, Emerging Markets Strategist / Fund Manager. At the stock level the global fund managers, in conjunction with the relevant analysts, construct a country portfolio for each country they are responsible for. We take an extremely pro-active approach to managing risk in our portfolios through rigorous risk budgeting both at the overall portfolio level right down to the stock level. We adjust each individual manager’s risk budget depending on performance and we apply a stop-loss rule to limit the damage that mistakes can do to the portfolios.

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