September 2021

Ten years in emerging markets

The emerging markets asset class is extremely varied. It includes democracies and dictatorships, economies reliant on manufacturing and those that export commodities, and – most importantly – some of the very best companies in the world alongside some of the very worst. If the last ten years investing in emerging markets has taught us anything it is that in the long run, quality wins.

Companies with high-quality fundamentals, if held patiently, can deliver both superior long-term compounding of capital, but also do so in a way that limits the risk of permanent capital impairment.

A case in point

An example of such a company is a consumer goods company in India which we have liked for over a decade.

The company's core product is coconut oil. The founder Harsh Mariwala worked to formalise, to brand and then to premiumize the category over many years. Multinationals struggled to compete with the company's local understanding, as well as its ability to source from smallholder farmers (it buys one in every 10 coconuts grown in India) and to distribute to 58,000 rural villages[1].

Emerging as the dominant player, the company has been able to sustain very attractive returns on invested capital of around 26% for the last decade*. What's more and crucially, because it sits in a very large addressable market, it has been able to retain around 60% of profits in the business and redeploy these into expansion[2].

This combination of attractive economics and growth, sustained over time, is often a powerful driver of share prices. Indeed, the company has been able to deliver annualised returns of around 24% for the last ten years[2].

It is the lure of such opportunities – of finding entrepreneurs who grow strong businesses responsibly over long periods of time – which drives our commitment to bottom-up stock picking.

> "Looking forward, today feels like a more exciting time to be an emerging markets investor than any in the past ten years."

Lessons learnt

Of course, whilst we may have judged correctly on many occasions over the last ten years, we have also been dealt plenty of harsh lessons through our own mistakes.

For many years, we owned Idea Cellular, an Indian telecoms company**. We assessed that in the future Indians would consume much more mobile data, leapfrogging broadband almost entirely. However, what we did not predict was the emergence of an aggressive new competitor in the form of Reliance Jio.

Reliance, backed by Mukesh Ambani, Asia's richest man, is the largest conglomerate in India. Its new telecoms business came equipped with both extremely deep pockets as well as close connections with government ministers. Through predatory pricing, Reliance drove Indian data prices to the cheapest in the world, and Idea Cellular slumped to losses.

We sold the remaining Idea Cellular holdings out of Global Emerging Markets Sustainability on 12 February 2018, after Idea's share price had more than halved. It is certainly fortuitous that we did; the share price has fallen by more than 80% since then.

It is scant consolation that our narrow assessment proved correct; amazingly, Indians now consume the most (extremely cheap!) mobile data per capita of any country in the world[3]. The lesson is clear; growth alone is not enough. Idea's business model unfortunately lacked the resilience and pricing power to be able to generate attractive shareholder returns from that underlying volume growth. No matter what price you pay for an equity, the downside risk can be 100% if you don't invest in quality.

Long-term returns

It is the combination of quality plus growth that leads to superior long-term returns, as in the case of the Indian consumer goods company. Compromising on quality of franchise by investing in Idea Cellular was a mistake. This is not entirely hindsight bias. We knew at the time the fragilities of telecoms businesses, but felt the data volume opportunity outweighed the risks. We were wrong.

It is our permanent mission as emerging markets investors to refine our ideas around quality and to continually raise the bar for the quality of companies we own for clients. Looking back over the last decade, we feel we certainly have done this. It is in fact all too easy to be embarrassed by the companies we held for clients many years ago! Plenty would not pass muster in our team today, and this is a very healthy sign of progress.

Emerging markets – expansion of the opportunity set

Looking forward, today feels like a more exciting time to be an emerging markets investor than any in the past ten years.

The number of exciting young companies coming to market – mostly but not entirely in China and India – is expanding the opportunity set rapidly***. Many of these private, founder-led companies are in growth areas with formidable barriers to entry. Quite a number are global leaders in what they do; be that 3D inspection technology for advanced manufacturing (Koh Young, South Korea), uninterruptable power supply for data centres (Voltronic, Taiwan) or outsourced medical research (Syngene, India).

We are very optimistic that more than a few of these opportunities will flourish in emerging markets over the long run.

Jack Nelson

[1] Annual report 2016-2017
[2] Bloomberg L.P. 2021
[3] Bloomberg Quint 16 June 2020

*Past performance is not a reliable indicator of future results.

**For illustrative purposes only. Reference to the names of each company mentioned in this communication is merely for explaining the investment strategy and should not be construed as investment advice or investment recommendation of those companies. Companies mentioned herein may or may not form part of the holdings of Stewart Investors.

***Certain statements, estimates, and projections in this document may be forward-looking statements. These forward-looking statements are based upon Stewart Investors' current assumptions and beliefs, in light of currently available information, but involve known and unknown risks and uncertainties. Actual actions or results may differ materially from those discussed. Readers are cautioned not to place undue reliance on these forward-looking statements. There is no certainty that current conditions will last, and Stewart Investors undertakes no obligation to correct, revise or update information herein, whether as a result of new information, future events or otherwise.

Investment terms

View our list of investment terms to help you understand the terminology within this document

Important information

This document has been prepared for general information purposes only and is intended to provide a summary of the subject matter covered. It does not purport to be comprehensive or to give advice. The views expressed are the views of the writer at the time of issue and may change over time. This is not an offer document, and does not constitute an offer, invitation, investment recommendation or inducement to distribute or purchase securities, shares, units or other interests or to enter into an investment agreement. No person should rely on the content and/or act on the basis of any matter contained in this document.

This document is confidential and must not be copied, reproduced, circulated or transmitted, in whole or in part, and in any form or by any means without our prior written consent. The information contained within this document has been obtained from sources that we believe to be reliable and accurate at the time of issue but no representation or warranty, express or implied, is made as to the fairness, accuracy or completeness of the information. We do not accept any liability for any loss arising whether directly or indirectly from any use of this document.

References to "we" or "us" are references to Stewart Investors. Stewart Investors is a trading name of First Sentier Investors (UK) Funds Limited, First Sentier Investors International IM Limited and First Sentier Investors (Ireland) Limited. First Sentier Investors entities referred to in this document are part of First Sentier Investors, a member of MUFG, a global financial group. First Sentier Investors includes a number of entities in different jurisdictions. MUFG and its subsidiaries do not guarantee the performance of any investment or entity referred to in this document or the repayment of capital. Any investments referred to are not deposits or other liabilities of MUFG or its subsidiaries, and are subject to investment risk including loss of income and capital invested.

Past performance is not a reliable indicator of future results.

Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell. Reference to the names of any company is merely to explain the investment strategy and should not be construed as investment advice or a recommendation to invest in any of those companies.

Hong Kong and Singapore

In Hong Kong, this document is issued by First Sentier Investors (Hong Kong) Limited and has not been reviewed by the Securities & Futures Commission in Hong Kong. In Singapore, this document is issued by First Sentier Investors (Singapore) whose company registration number is 196900420D. This advertisement or publication has not been reviewed by the Monetary Authority of Singapore. Stewart Investors is a business name of First Sentier Investors (Hong Kong) Limited. Stewart Investors (registration number 53310114W) is a business division of First Sentier Investors (Singapore).

Australia

In Australia, this document is issued by First Sentier Investors (Australia) IM Limited AFSL 289017 ABN 89 114 194 311 (FSI AIM). Stewart Investors is a trading name of FSI AIM.

United Kingdom

This document is not a financial promotion. In the United Kingdom, this document is issued by First Sentier Investors (UK) Funds Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 143359). Registered office: Finsbury Circus House, 15 Finsbury Circus, London, EC2M 7EB, number 2294743.

European Economic Area ("EEA")

In the EEA, this document is issued by First Sentier Investors (Ireland) Limited which is authorised and regulated in Ireland by the Central Bank of Ireland (registered number C182306) in connection with the activity of receiving and transmitting orders. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland, number 629188.

Middle East

In certain jurisdictions the distribution of this material may be restricted. The recipient is required to inform themselves about any such restrictions and observe them. By having requested this document and by not deleting this email and attachment, you warrant and represent that you qualify under any applicable financial promotion rules that may be applicable to you to receive and consider this document, failing which you should return and delete this e-mail and all attachments pertaining thereto. In the Middle East, this material is communicated by First Sentier Investors (Singapore).

Kuwait

If in doubt, you are recommended to consult a party licensed by the Capital Markets Authority ("CMA") pursuant to Law No. 7/2010 and the Executive Regulations to give you the appropriate advice. Neither this document nor any of the information contained herein is intended to and shall not lead to the conclusion of any contract whatsoever within Kuwait.

UAE - Dubai International Financial Centre (DIFC)

Within the DIFC this material is directed solely at Professional Clients as defined by the DFSA's COB Rulebook.

UAE (ex-DIFC)

By having requested this document and / or by not deleting this email and attachment, you warrant and represent that you qualify under the exemptions contained in Article 2 of the Emirates Securities and Commodities Authority Board Resolution No 37 of 2012, as amended by decision No 13 of 2012 (the "Mutual Fund Regulations"). By receiving this material you acknowledge and confirm that you fall within one or more of the exemptions contained in Article 2 of the Mutual Fund Regulations.

United States of America

In the United States, this document is issued by First Sentier Investors International IM Limited, as SEC registered investment adviser. Stewart Investors is the trading name of First Sentier Investors International IM Limited. This material is solely for the attention of institutional, professional, qualified or sophisticated investors and distributors who qualify as qualified purchasers under the Investment Company Act of 1940 (hereafter the "1940 Act"), as accredited investors under Rule 501 of SEC Regulation D under the US Securities Act of 1933 ("1933 Act), and as qualified eligible persons as defined under CFTC Regulation 4.7. It is not to be distributed to the general public, private customers or retail investors.

Other jurisdictions

In other jurisdictions where this document may lawfully be issued, this document is issued by First Sentier Investors International IM Limited which is authorised and regulated in the UK by the Financial Conduct Authority (registration number 122512). Registered office 23 St. Andrew Square, Edinburgh, EH2 1BB number SC079063.

For more information please contact:
client.engagement@stewartinvestors.com

Or visit our website at stewartinvestors.com and dedicated sustainability microsite at sfg.stewartinvestors.com

Copyright © (2021) Stewart Investors. All rights reserved.