EMERGING WEALTH UPDATE

Week Ending November 19, 2021

GW&K INVESTMENT MANAGEMENT

Market Performance

For the week ended November 19, 2021, Emerging Market (EM) equities, as measured by the MSCI EM Index, decreased by -1.3%. The weakness was most pronounced in Latin America, where Peru, Argentina, Columbia, Chile and Brazil all declined by more than -5% for the week. China and India declined by -2.1% and -1.6%, respectively. Taiwan, with an increase of +2.4%, was one of the strongest countries. By sector for the week, Consumer Discretionary was the weakest with a decline of -4.8%, followed by Energy and Materials with declines of -3.8% and -2.4%. The strongest sectors were Technology and Healthcare with returns of +1.4% and +1.8%, respectively. For the week, Growth outperformed Value with a decline of -0.9% compared to -1.6%.

For the YTD, the MSCI EM Index was up only +0.1%, which lags the +21.2% return of the MSCI World Index. For the YTD, energy rich countries continue to be at the top of the performance list with the UAE, Saudi Arabia and Kuwait generating returns between 35% and 50%, and Russia increasing by +27%. Peru, with a return of -22%, was the weakest performing country followed by Turkey and Brazil with declines of -19%. China continues to be among the weakest countries YTD with a decline of -14.8%. Turkey and Brazil are at the bottom of the list with declines of -21.3% and -19.8%, respectively. For the YTD, Energy continues to be the strongest sector with a return of +19.3%, which is in sharp contrast to the decline of -19.2% for Consumer Discretionary. YTD, Value has materially outperformed Growth with a return of +4.6% compared to a decline of -4.0% for Growth.

China – Common Prosperity Sets the Stage for Sustainable Growth

We have written much about China and its culture, economy and the opportunities for investment over the past several years. China is clearly on the rise as a global power, but it faces many challenges which have been in the headlines this year. On the list of challenges are the slowing of the economy, the correction in real estate prices, the rising cost of education, the environment, tensions in Hong Kong and Taiwan and Covid-19 lockdowns. The Chinese government this year has taken many steps to address these challenges. At the top of the list of government actions has been the unprecedented steps taken to reform the economy. This has created uncertainty for investors. The negative sentiment with respect to Chinese investments has continued to grow as the year progressed. There are only minor signs the Chinese equity market has bottomed. As noted above, the Chinese equity market is one of the worst performing countries for the YTD with a decline of -14.8%. For comparison, the MSCI World Index of Developed Market (DM) countries is up +21.2% and the U.S. stock market is up +25.4%. The gap between the U.S. stock market and the Chinese equity market is one of the largest on record.

In the Emerging Wealth Strategy, we have retained our position in Chinese equities and have been gradually adding to our position. While investors question every aspect of the Chinese economy, our conviction in the sustainability of growth has increased and we believe the government retains its commitment to rewarding shareholders of companies that provide solutions consistent with government policy. At the top of the list of priorities is rising per capita income, especially for the lower segments of the population, and affordable living costs for the middle class. The Common Prosperity initiative announced this year is focused on providing affordable housing, healthcare and education for the middle class. The government views this initiative as essential for addressing the long term demographic challenge China faces. The regulatory actions taken this year have been designed to address many of the excesses in real estate, education, social media, healthcare costs, lending and the excessive power of some entities that were crowding out smaller businesses in some markets. The government's actions also target rising income inequality. Reading many of the policy changes carefully, we have concluded these changes enhance the sustainability of growth for the Chinese economy. However, the unprecedented regulatory announcements have caused investors to believe the government is no longer interested in the capital markets and in rewarding shareholders. We disagree. Instead, we have concluded the reforms set the stage for a more sustainable operating environment for companies that do business in China. The government wants a healthy and vibrant capital market but is much more mindful of reigning in excesses which potentially exploit the consumer or are harmful to culture.

There are two very important points to keep in mind with respect to investing in China. There is no tolerance for any exploitation of the consumer, and the government will act quickly to address excesses. Over the next six to twelve months, we believe signs will emerge that the regulatory process is largely completed and the government will begin to restore investor confidence. In this regard, we believe the speech given on October 15th by Xi Jinping, highlighted below, was an early sign that China is attempting to find the balance between encouraging and rewarding entrepreneurs while at the same time addressing costs for the middle class and income inequality.

Principles to Promote Common Prosperity

Excerpts from Xi Jinping's speech titled Principles to Promote Common Prosperity delivered to the Central Committee of Financial and Economic Affairs on October 15, 2021 are below:

- Encourage entrepreneurship, and strengthen the person's ability to create wealth.
- Avoid "involution" and "laying flat."
- It is necessary to allow some people to get rich first.
- At the same time, it is necessary to encourage those rich people to lead and help others to get rich together.
- Encourage and support people who work hard, operate legally and are willing to start a business. Discourage illicit business practices to get rich.
- Government should never raise the bar too high for social welfare and over-protect the people, and firmly prevent falling into the "welfare trap" and making people lazy.

This speech was not well covered in the western media. It signifies the regulatory process has passed through its most intense period and the time has come to fine-tune the message. We expect that the government will gradually announce that most of the major reforms needed have been implemented. This will gradually restore investor confidence in the government's commitment to the capital markets and economic rewards for shareholders. The severe underperformance of Chinese equities this year has led to a very attractive valuation level for Chinese equities especially compared to the U.S. equity market. We expect Chinese equities to significantly rerate over the next 6-12 months as the country emerges from lockdowns from Covid-19 in the wake of the Beijing

Olympics, Xi Jinping being appointed for another term and the government reaffirms its commitment to the capital markets.

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