EMERGING WEALTH UPDATE

Week Ending May 7, 2021

GW&K INVESTMENT MANAGEMENT

Market Performance

For the week ending May 7, 2021, Emerging Market equities increased by 0.1%. As has been the case for most of 2021, the market was led by strong performance in some of the commodity oriented countries including Chile, Mexico, Russia and South Africa, which have underperformed for several years and are now getting a cyclical tailwind as the global economy recovers from the depths of the pandemic in 2020. Copper prices have hit new highs not only driven by an economic recovery, but the shift to alternative energy, which drives demand for electric vehicles, charging stations, solar power and wind power. After years of underspending, demand for copper is projected to outpace supply for several years keeping upward pressure on prices. Energy has also recovered materially from the lows of 2020. In the short run, a rally in countries and companies exposed to the natural resources makes sense. The challenge will be if companies are able to bring earnings and cash flow to the bottom line and return cash to shareholders after capital spending for expansion and a likely increase in taxes and other fees imposed by countries who realize the value of these assets. All of the countries mentioned above are up more than 10% for the year-to-date compared to a return of 4.9% for the Emerging Market Index. Surprisingly, India also outperformed last week and is now outperforming for the year-to-date despite the tragic news about the pandemic spreading and hospitals being overwhelmed. There was evidence this week that lockdowns are stemming the spread of the virus in several states. Investors are willing to look through the near-term challenges and focus on the bright prospects for India in the years to come. China last week continued to be weak with a decline of -2.2% and the country is now down -1.3% for the year-to-date. After years of outperformance, investors are fleeing growth stocks due to concerns ranging from regulatory scrutiny, ongoing trade concerns and a tempering of relative economic growth as the year progresses. It is an opportunity for investors willing to look over the horizon but for now, investors are in no rush as the momentum trade has moved on to greener pastures. Like India came back this week, China is likely to come roaring back with little advance notice for investors. Investors who stay the course will be rewarded as the long-term fundamentals for China are too good to be ignored for very long. Sector performance for this week is consistent with the country performance with energy and materials advancing by 3.8% and 4.6%, respectively, ahead of the Emerging Market Index. For the year-to-date, energy is outperforming with a return of 6.2%, but no other sector compares with the return of materials, which is up 23.8%. All other sectors are up less than 10% and consumer discretionary is the worst performing sector with a decline of -3.8%. Last week the Value style increased by 0.9%, which outperformed the Growth style, which had a decline of -0.7%. This is a significant margin for a one week period. For the year-to-date, Value has outperformed Growth by 480 bps. As each week passes, the shift to Value presents higher expected returns for Growth oriented strategies and investors who have longer-term investment horizons. But nothing comes without a test and this is it. Stay the course.

Guiding Light – Do You Have One?

What is going on in this market? Value? Growth? Crypto? Inflation? Commodities? Cyclical recovery? Debt? Interest rates? Investors trying to catch every wiggle and waggle in the market are perplexed as they should be. Never before have so many forces come together in the history of the financial markets. Massive government stimulus, pent up demand as consumers newly vaccinated feel the urge to spend, shortages of labor, materials, semiconductors and consumers willing to wait and pay a higher price. Treasuries yields remain stubbornly below 1.6% despite mounting evidence of rising inflation, the mother of all inflation trades. Just look at copper. Growth stock investors are on the back foot concerned about a shift in sentiment and the direction of interest rates. It feels like something is brewing like a pot ready to boil over. In time it will all be clear and, the one pundit who stuck his or her neck out with a bold prediction, will be crowned the new messiah. But, what will it be and when? No one knows for sure. In the meantime, possibly the most used word in the financial lingo is "transitory." And it is until it is not.

Emerging Wealth Guiding Light

The global economy is in the midst of a very powerful economic recovery which we believe will continue for the next several years. It is a constructive environment for Emerging Market equities. Some of the factors mentioned above, style of management, inflation, interest rates and rising commodity prices will likely create periodic bouts of volatility. Our guiding light through these periods is rising per capita income and domestic consumption in emerging markets – an enduring trend for the next 5-10 years. This is a structural trend that is becoming increasingly important to global growth. Our focus is on owning the companies that are best positioned to participate in this secular opportunity and generate returns for shareholders. Fundamentals of the companies we own are improving through the first quarter as the world and emerging markets recover from the challenges of 2020. In time, investors will return to strategies and companies with the strongest fundamentals and sustainable growth opportunities.

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