EMERGING WEALTH UPDATE
Week Ending July 30, 2021

GW&K INVESTMENT MANAGEMENT

Market Performance

For the week ended July 30, 2021, Emerging Market equities declined by -2.5%. The decline this week was led by a -6.1% decline in China. For the month of July, EM equities were down -6.7% and for the year-to-date (YTD) were up +0.2%. For the month and year-to-date, China is the weakest of the larger countries in Emerging Markets. China was down -13.8% for the month and is now down -12.2% YTD as investors reduce their positions in the wake of regulatory pressures, which increased in intensity over the past two weeks. The Materials sector was up +1.8% for the month and continues to be the strongest sector YTD with a return of +20.6%. The weakest sectors for the month were Consumer Discretionary and Real Estate with declines of -14% and -17.4%, respectively. They were also the weakest sectors YTD with declines of -13.8% and -17.2%, respectively. The Value style of management continued to outperform Growth for the month and YTD. Value declined by -4.8% for the month and has increased by +4.8% YTD. This compares to Growth which declined by -8.6% for the month and is now down by -4% YTD.

China – The Tiger Roars and Investors Head for the Exit

Investors worldwide are probably well aware we are in the midst of a material selloff in Chinese equities. The Chinese equity market was down -6.1% this past week and down -13.8% for the month of July. For the YTD, Chinese equities are down -12.3%, making China, with a weight of 35%, the worst performing country of meaningful size in the MSCI Emerging Market Index.

Why has the Chinese market been so weak? The Chinese government surprised global investors by stepping up the intensity of regulatory changes over the past few weeks. This is consistent with a government policy to reign in excesses that started with the anti-corruption campaign initiated in 2012. Overall, stepped up regulation has been successful in reigning in excesses that threaten the Chinese financial system or exploit consumers, and are designed to prevent social unrest.

Common Prosperity – A New Initiative

In the celebration of the 100th year anniversary of the Chinese Communist Party (CCP), the government introduced a new initiative called “Common Prosperity.” Common Prosperity is aimed at reducing the cost of living for the next level of expenses for the middle class and to encourage larger family units as incomes rise. It is aimed at providing affordable housing, healthcare, elder care and education.

The government decision to convert the education industry to non-profit was unexpected and went further than reforms in the past. Because after school tutoring had become a large part of the family budget, the government made a decision that education was the government’s responsibility and decided to convert it to a non-profit industry. This action has raised questions about the government’s commitment to capitalism for solving problems and uncertainty regarding whether their moves will be extended to other industries. Investors, especially global investors, are currently not waiting for the answer and are exiting.

This represents the views and opinions of GW&K Investment Management and does not constitute investment advice, nor should it be considered predictive of any future market performance. Data is from what we believe to be reliable sources, but cannot be guaranteed. Opinions expressed are subject to change. **Past performance is not indicative of future results**.

GW&K INVESTMENT MANAGEMENT

Capitalism with Chinese Characters

The GW&K Emerging Wealth Strategy retains our long-term commitment to the Chinese equity market and companies exposed to the growth of discretionary spending. We continue to believe that China before and after this period will remain one of the fastest growing economies over the next 10-20 years. The economy is in the midst of a shift to domestic consumption which we expect will lead growth for many years to come. The commitment to capitalism by the CCP has not changed. The capital markets are essential for solving a myriad of challenges for China in industries ranging from financial services, insurance, credit, ecommerce, payments, healthcare, travel, entertainment and consumer goods and services. Capitalism has solved problems for China over the past 40 years and has helped the country bring hundreds of millions of people out of poverty in addition to achieving remarkable economic growth. We believe capitalism and the companies that service the consumer consistent with the direction of the Chinese government will continue to benefit in the years ahead.

Regulation will always be part of investing in China. Overall we've seen the government make good decisions and when mistakes have been made we've also seen decisions reversed. We believe the Common Prosperity initiative will accelerate the shift to domestic consumption and also accelerate consumer discretionary spending. Additionally, Common Prosperity is designed to facilitate larger family units to address China's demographic challenge. Greater domestic consumption and larger family units are among the highest priorities for the government.

As mentioned, we retain our commitment to the Chinese equity markets and the companies worldwide that are exposed to what will soon become the largest consumer market in the world. The pendulum, in terms of regulation and investor sentiment, has now swung to an extreme level. As to why this is happening now - China went through the pandemic better than any other country in the world. The country is in a strong position, and the 100th year anniversary of the CCP makes this the perfect time for the government to address excesses and areas of concern to set the stage for the next level of growth. We recognize this period is painful to go through, but we believe that the pendulum will swing back as the government gets through this phase of regulation and those Chinese companies that are well-positioned will see their premium valuations restored.

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