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Emerging markets equity investing

How to read the huge emerging markets discount

Emerging markets look extremely cheap. But are they cheap for a reason? Robeco brings some 70 years of investment experience to the table to discuss the risks and opportunities that emerging markets offer in these volatile times.

Below is a transcript from a podcast conversation with three investment experts: Wim-Hein Pals, head of Robeco Emerging Markets Equity; Wilma de Groot, head of Robeco Core Quant Equities; and Michiel van Voorst, portfolio manager for Robeco Next Digital Billion.

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Erika van der Merwe (EM): The potential for higher returns is one of the main reasons for investing in emerging market stocks. But how has this played out for investors over time, and what does it really take to succeed when one ventures into this risky asset class? For this bumper podcast episode, we've invited three investors to cover the ground. Each of them has a distinctive approach to emerging markets. Wim-Hein Pals is head of Robeco Emerging Markets Equity. Wilma de Groot is head of Core Quant Equities. And also joining us is Michiel van Voorst, who's portfolio manager for the Robeco Next Digital Billion strategy. Welcome, super to have you all around the table with me.

Guests: Thank you.

EM: Before we start, I think it would be super helpful if you could each introduce yourselves, just to give us a perspective on what exactly your approach is to emerging market investing. So Wim-Hein, your perspective and your team's perspective, how do you go about emerging market investing and how long have you been doing this?

Wim-Hein Pals (WP): Well, I've been very lucky and happy, actually, to be one of the founders of the emerging markets strategy back in the early nineties. So I'm doing this for sort of 30-odd years with a lot of excitement and pleasure. And our style, I would characterize it as value with a future. So we are value investors, value-tilted investors, but we also look at earnings and business profile and that should be enhancing the strategy as well.

EM: Wilma, at the other end of the table and a completely different approach along the continuum.

Wilma de Groot (WG): Yeah, our approach are factor-based quant equity strategies and we manage in total around EUR 75 billion in quant equity strategies, of which EUR 25 billion in emerging markets. And I've been doing this over 20 years, I also wrote my PhD thesis in this area.

EM: And Michiel, our growth investor. Is that right? How do you do it? How do you look at it?

Michiel van Voorst (MV): I joined Robeco's trend investment team two years ago. Before that, I spent 12 years living and working out of Hong Kong in Asia and have been analyzing and following emerging markets for 25 years. So our perspective is very much from a growth angle and a trend-based approach so looking for a structural, long-term trend and try to capitalize on that within the context of emerging markets.

EM: So there you have it. We have the heavyweights around the table to discuss emerging markets. And certainly now with emerging markets having recently been catapulted again into the news, we have plenty to discuss and we'll structure the conversation by first looking at the drivers of emerging market equity performance over time. Given the profile of our guests, I expect that we'll very soon transition into the discussion on whether emerging markets are a value or a growth opportunity. And then, since responsible investing is top of mind for most institutional investors, we'll look at how realistic it is to invest sustainably in emerging economies. And stay with us to the end of the conversation when we'll ask what opportunities these investors see right now. Wim-Hein, starting with you. Before we touch on current geopolitical events, what generally are the factors and drivers for emerging market stock performance over time?

'This discount in emerging markets is more than translating the geopolitical risks…that's a 30-odd percent discount you get in emerging markets relative to developed markets. So, there's a lot of risk incorporated into today's share prices'

WP: Well, it's the growth in economic terms. So in the consumer spending, the growth of the middle class, which is highest in countries like China, Indonesia, India, Brazil as well. So that is one of the main characteristics, the high economic growth. It's much higher growth than in the developed world, in general. A couple of percentage points more GDP growth annualized than in the developed world. And also for decades, the long-term average valuation is lower than in developed markets. So this discount in emerging markets is more than translating the geopolitical risks you were referring to and all other risks. So at this very moment we are very low valued from a P/E perspective. You're talking price/earnings ratios, average 12 versus an average of 18 for the developed markets. So that's a 30-odd percent discount you get in emerging markets relative to the developed markets. So there's a lot of risk incorporated into today's share prices. That's an important message.

EM: Michiel, this sounds a little bit of your kind of approach. From what I understand, you look at the emerging middle class.

MV: True. But as trend investors what we are trying to play is companies that cater to the next generation of internet users. And as a matter of fact, most of them live and work in emerging markets. So that's our perspective, looking at the countries that have all basically reached their critical point of internet adoption and especially in the countries where that flipping point happened like 10 years ago, what you see is that there is a whole ecosystem of companies emerging that is catering to that next digital billion of internet users. And those are the companies we're interested in. And you see these companies emerging in countries like indeed Brazil and Indonesia and India, but also other places like Nigeria or Egypt that people may be not thinking of immediately, and of course, China. So it also means that some of the typical emerging markets are outside of our scope because from our perspective, they look much more like a developed market. So in that sense, we pick our own countries of interest.

EM: Wilma, a factor approach. How do you see the numbers? What are the drivers there of returns in portfolios?

WG: So the academic research to factors all started in developed markets, actually to be precise in the United States. And the research shows that value stocks and momentum stocks, so stocks with cheap characteristics which have a low price-to-earnings, a price-to-book, or companies with a high past-year return, that they on average do better in the long run than stocks with the opposite characteristics. And in developed markets this research dates back to the seventies, but in emerging markets it's much younger.

Around 2000, the first publications started and our own over 25 years of experience in this area shows that valuation, momentum and quality type of factors also work very effectively in emerging markets. And of course, after that, much more research has been published. For example, that these type of factors also are very effective in the upcoming emerging markets, like the frontier emerging markets, or in markets that have more recently opened up for international investors, like the China A-share market. And besides these return factors, we also find that the low-risk anomaly, so the idea that low-risk stocks on average earn a higher return than high-risk stocks, that that's also a very effective phenomenon in emerging markets.

'We find that the low-risk anomaly, the idea that low-risk stocks on average earn a higher return than high-risk stocks, is also a very effective phenomenon in emerging markets'

EM: But now listening to the three of you, the way you're describing it, I suppose that's also in my question, it sounds it's just all blue sky, great possibilities. But if you look back, of course, and also knowing how long you three have been doing this. If you look back in time, there regularly are shocks in the emerging market universe: debt shocks, geopolitical shocks, terms of trade shocks. All of which knock either certain regions within emerging markets or the whole universe. So at times it feels like it's one step forward and two steps back. How do you manage this uncertainty and the pain? Michiel, starting with you.

MV: Clearly, because our strategy has been impacted of late by some of these factors that you mentioned. I would like to say, by the way, it's typically more two steps forward, one step back, at least that's what I generally believe. But clearly global interest rates are important to emerging markets and we've seen that especially last year, that many emerging markets were forced because of what was going on in the global economy to take up their interest rates. And that has had an impact on the stock prices of our companies, no doubt about it. And on top of that, of course, the uncertainty coming out of China and recently the conflict between Russia and Ukraine have all had a tremendous impact. And we've seen sharp price corrections in our stocks.

But if I look at the fundamentals and if I see my companies reporting, what we observe is that, many of their reports are still very strong. Underlying growth continues. The companies are just continuing as is. And so our point of view is very much like prices have corrected much more than fundamentals. So that also opens the door for opportunities. And I generally believe that we're there. You can buy many of these stocks now at prices that are below two, three years ago, while their sales base is basically double, triple and their profits are double, triple. So I think that's an opportunity.

EM: So what you say is when clients are knocking at the door, asking you about the performance or are you concerned at what's happening in the universe, your response is, you stay with the basics, you look at the fundamentals and you remain convinced?

MV: Well, history teaches you that strong companies with strong business models come out of these periods of uncertainty and distress stronger than before. And I think that's the situation we're looking at.

EM: Wilma, what happens to a quant model in a time of crisis?

WG: This also relates very much to the discussion of country allocation versus bottom-up selection within these countries and sectors. And what we find is that research shows that also country allocation, there is a return to be gained in the long run, but it's much more difficult to predict also because of these crisis periods or the crisis that can happen in individual countries. So our focus in our return strategies has much more been on the selection within the countries and the sectors compared to the country allocation. So we limit the deviations of countries compared to the index as much as possible, and that has also paid off in this crisis situation. For example, recently in Russia, where we were on average underweighted, which was beneficial for the strategies.

EM: So you're saying this is a general adjustment to your process or in response to a crisis?

WG: No, this is just a general application of our process.

EM: Well, let's touch on some of the reasons for the recent performances in emerging markets. And this is even before we get to what happened with Russia and Ukraine. Now, the March 2022 edition of IPE magazine has an article aptly entitled 'Now is not the time to give up on emerging markets'. I don't know how you'd respond to that title, but it looks at the performance. It says emerging markets underperformed their developed-world peers in 8 of the past 14 years, and in the past decade they had an average return of less than 5%. Then in 2021, the MSCI Emerging Markets Index dropped by 2.2%. Now contrast this with the MSCI World Index, which went up by 22.3%. So why this lackluster performance up to that point? Wim-Hein, you refer to valuations, but this is another layer to that.

WP: Yes, that's the point. I would like to stress here that all the good news has been discounted in the prices, the share prices of developed markets, right? Strong growth in the internet space, in the US, and in the growth names there. And all the bad news has been discounted in emerging markets share prices. So we are around the perfect entry point into emerging markets after this period of underperformance as you were referring to. Which gives the new investor in emerging markets a very interesting entry point with low valuations. A lot of shocks as you were referring to earlier as well, have happened, so are in the share prices of today, as markets are pretty efficient. So from now on investors are very underweight the asset class and do look, in an environment of interest rate hikes in the US, do look at attractively valued asset classes. And emerging markets, however you look at it, is an interesting asset class from a valuation angle. It's underinvested, undervalued at the current stage. So there is an anomaly which you can benefit from over the longer term. The undervaluation will not disappear overnight or over a couple of months, but it will over the next couple of years, is my conviction, disappear or gradually converge to the valuations in developed markets.

EM: So it requires that patience and being opportunistic. I'd like to play you a clip which refers to some of the points that you made here by Ruchir Sharma.

Audio fragment: *Markets are down by a similar proportion this year, and that also is unusual because typically emerging markets have a higher beta than the rest of the world, the US or other parts of Europe. But this time they've all fallen exactly in line, which already tells me that that is a divergence that's opening up, that a lot of people have already exited emerging markets. The consensus is too pessimistic. And so therefore a lot of selling that's taking place. I mean, if you look at the outflows from emerging markets, they've been very strong. Despite those massive outflows, the performance of emerging markets hasn't been that bad in an environment such as this.*

EM: That's Ruchir Sharma, author of Breakout Nations and subsequent books, talking to CNBC. Michiel, you might want to pick up on some of those points, but also I'd like to ask you if we look at what's happening right now geopolitically, with the Russia-Ukraine crisis, you mentioned China earlier. What exactly is happening in emerging markets? Is it a commodity play? Is it a play on what the Fed is doing with interest rates? How do you see the dynamics?

MV: Oh, well, that's a broad question. So let me first respond because I think he's making a couple of good points. And if you think about investing, Wim-Hein has touched upon valuations, which are important, what do you pay for the asset and what are the embedded expectations? Very important, but there are other factors as well, like how much exposure is there already? He mentioned the fact many people have already left so that there is no incremental seller and you can start looking for the incremental buyers and that behavior, so basically market price behavior, is also an important indicator. So I like the way he analyzes it and Wim-Hein already mentioned it. It's like the asset class is trading at a big discount and I recall that also back in 2007-08 when everyone was super bullish on emerging markets that they actually traded at a small premium over developed markets because everyone was looking for that opportunity set.

So you see that sentiment also goes and comes in waves and I like to believe like Wim-Hein that we're looking, or that we're at the bottom of one of these waves. I think the underperformance can also be partially explained because you invest in emerging markets, I believe, because you have the prospects of more growth, more profit growth, because ultimately, for equity investors, it's about profit growth. That's what I strongly believe. And emerging markets, by and large, have not delivered on that promise over the past ten years. And actually you got more out of the US, so no surprise in the way that the US market has done better. So what we should look for is indeed the promise of that reacceleration of growth. And what you can say is that many of these countries are in a pretty good place where their macroeconomics are pretty sound. And that is an opportunity, right. So not a lot of exposure is there, valuations are cheap, sentiment is pretty poor. We have had a couple of big crises right in front of us. If we can come out of that. I think the set-up is very good.

EM: Yes. But the US is pushing up its interest rates. History has also shown us that that is not a good place for emerging markets to be.

MV: Yeah, that is the typical way of looking at it. And that's also because, typically speaking, the macroeconomic profile of emerging markets is more vulnerable. I actually have hardly seen any periods where if you think about external deficit, fiscal deficit, sound macroeconomic policies, a lot of emerging markets are looking pretty good on that front. So the vulnerability is less today than it was in the past. That is how I look at it.

WP: And if I may, history shows that in a period of rising long-term interest rates in the US, so not looking at the fed funds rate, but at long-term rates, so US 10-year Treasuries, in a period of rising US 10-year Treasuries, emerging markets tend to outperform developed markets. And that might sound like a paradox, but it's not, because it comes with growth. The growth-inspired interest rate hikes are very good news for emerging markets, which are growth sensitive. With still a lot of exports going out of China to the rest of the world, going out of Indonesia to the rest of world. Or talking about commodities going from emerging to developed markets. So that's also an interesting phenomenon currently.

MV: And many of the currencies are very strong at the moment in emerging markets, which is also basically highlighting that actually, fundamentally speaking, these countries are in a pretty good place.

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EM: Which could shift again with higher US interest rates?

MV: Yeah, but then you would expect, as markets are discounting mechanisms, that starts to be reflected in these currencies. And that's not necessarily what we're seeing. Of course, there are exceptions. But by and large.

EM: Wilma, a cool, calm approach here. Let's switch away from the fundamental perspective. What do the numbers tell you, first of all, on valuations and how would you react to this discussion around interest rates?

WG: If you look at the past couple of years, I think emerging markets have indeed typically been more growth-oriented, more growth-like, but it's also more becoming core now. If you look at the past year then the typical growth stocks, they have also had a strong return decline. And that, of course, has been good for value investors, right. So that is the benefit of that.

EM: I'm going to switch focus and ask you about the motivation for having emerging markets in your portfolio. You've touched on this, Michiel, from your perspective, the growth opportunity. We ran a poll on LinkedIn asking our readers what they feel, if emerging markets have a role in a diversified portfolio. A small minority, 13%, said emerging markets are irrelevant to them and the rest, it was a mix, but to all of the rest it had a role, whether it's a small part, a key part, or of rising importance. Michiel. Are emerging markets a growth or a value opportunity then? I think you've made it pretty clear from your perspective: growth.

MV: Let me be a bit more specific here, because I'm not a big believer in these value versus growth. For me, it's about what do you pay for an asset, right? So it's the valuation that matters. But for me, it's less about, I like value or growth at value. Companies that can outgrow other peers and but where you pay a reasonable price, that's what we are looking for. And I think that's in place. So I'm less biased to the value case. Valuation matters to me.

EM: That's right. And a clear difference there between the value-growth debate, which refers to the kinds of sectors that you'd invest in, as opposed to valuations. Wim-Hein, your reaction?

WP: Well, the beauty about emerging markets is the diversification, I would also like to stress. And there valuations vary across all countries. And we start our process with country allocation and then valuation is an important characteristic. So you're going from 30+ times price/earnings in some countries to below ten times earnings in Korea and in some other Asian markets, which are very healthy from a growth angle.

So it's always a matter of balancing act between this valuation and the growth potential in that particular country. So that is key in investing in emerging markets, looking for the diversification. So you can have one shock in one country, but you diversify it away in nice returns in other countries, like year to date Latin America is flourishing. It's up 20, 30%. All these markets in Latin America. Why? Because they are commodity-rich nations and we are all scrambling for nickel, copper, other base metals and bulk commodities like iron ore and the rest of it.

EM: And soon also food.

WP: Exactly. It's a very rich continent from a resource perspective and from a commodities perspective. So all of a sudden that comes to life where it was not performing at all for the last couple of years because it was all 'growthy' sectors like Chinese internet, not so much in 2021, but before that it was all growth sectors. And now these value sectors within emerging markets, like materials, mining, steel are coming back to life. So that is an important angle as well.

MV: If I may, Wim-Hein, because actually so Brazil, for instance, and Argentina have been performing well but also in our portfolio right? So again, looking for companies that cater to the digital consumer and the next generation of internet users. And also there we see that as these economies come out of their slump, that also that part of the economy is also benefiting and these stocks are going up. So it's both from a value and a growth perspective that things are moving in the right direction there.

EM: Wilma, for you, from a practical perspective, how do you implement this? Where you see the opportunity, how do you adjust things?

WG: Actually, it's of course, indeed, not only value, right. We look at companies that are cheap from a valuation perspective, but also the diversification element that Wim-Hein was referring to is crucial. So the combination of looking for cheap stocks together with stocks that have a strong momentum, growth-related, you could say, and also good quality, sound quality characteristics in terms of, for example, whether companies are reducing their debt or have good profitability characteristics. Yeah, that's important when selecting stocks. So that combination, that is, stocks that score well on the combination of these characteristics, they are in general the ones that also seem to perform better in the long run.

EM: I want to look now at what it takes to invest in emerging markets. Clearly, as we've heard so far, different kinds of approaches, methodologies and processes work. It is a hugely complex universe and it's almost an accident of history that this grouping of countries are categorized together. I found this quote from the Economist that says: 'What counts as an emerging market? Broadly speaking, an economy that's not too rich, not too poor, not too closed to foreign capital'. The quant perspective on this, Wilma, which factors are relevant in this world of complexity?

WG: Well, of course, emerging markets are quite different from developed markets. And at the same time, and I think That's also a strength, we find that similar types of factors work well in emerging markets as well as in developed markets. I think the key difference of investing in emerging markets, especially from a quant perspective, is actually that liquidity in emerging markets is much lower. And that has impact, of course, on trading costs. So exploiting these factor premiums in emerging markets is much more challenging. And that especially holds also for more faster-moving factors. And actually, the more newly published factors that we find also in academic research, they are also faster in nature. So they have a higher turnover. For example, if we look at news sentiment, the idea that stocks, which have been more positive in the news, also have a higher return on average in the future. News-related, you can imagine that this is a faster signal.

So taking trading costs into account when exploiting this information in a strategy is, in our opinion, crucial because otherwise it can destroy your whole return perspective. So the way to deal with this is to focus on net return, the trade-off basically between the gross return and the trading cost involved with it. And that's also quite a difference with academic research, where generally trading costs are not taken into account in these research studies. In general, what you see is that portfolios are built based on a particular characteristic, top portfolio, bottom portfolio. And then after a month, if a stock doesn't belong to the top and the bottom anymore, it's sold and new stocks are bought. But if you do this, especially for these signals, that can be really fast. Yeah, that can have a large impact on your return.

So one of the ways to deal with this is to keep on holding these stocks for a longer time, even though the stock becomes less cheap or has a somewhat reduced momentum, and there are other candidates that might score better, but still to hold on these stocks, to reduce the turnover in the strategy. And I think that's a very important one. Of course there are also other ways to reduce trading costs. You can also take trading cost estimates into account to determine the position size or the trade size. Basically trade smaller in more expensive stocks. Also the trading itself, trade patiently, wait, and don't rush too much, take your time for trading, it all helps, of course, to exploit this net return as much as possible.

MV: Maybe it's good to mention that actually a lot of the insights coming from the quant research, actually fundamental investors like ourselves are also applying. So I also monitor these scores and apply it to our portfolio as well. But we start off as fundamental investors and in the end, I'm a bottom-up stock picker, but still the insights I think, are still valuable also for fundamental investors. And that's also because the models are based on deep, fundamental beliefs. Right?

WP: And here comes the investment horizon as well, which is important. Wilma was referring to the high trading costs in emerging markets, which is true. So you have to have a long-term investment horizon to get your returns and to get your alpha, your excess return over your competitors, which have typically a shorter investment horizon. We have a 24% average annual turnover. So we trade our portfolio once every four years. So that's a four-year investment horizon, right? That is pretty long, but it comes with lower trading costs and which translate automatically in your higher returns going forward.

‘We trade our portfolio once every four years. That is pretty long, but it comes with lower trading costs, which translate automatically in higher returns going forward’

MV: Same here, by the way, because we run a fairly concentrated portfolio of 45 names or so, and we try to pick local winners. I like to believe that ten years from now, these stocks will still be in our portfolio.

EM: Now we know that investors everywhere are serious about targeting sustainability with their assets. And we saw this again recently with the Robeco Climate Survey confirming how institutional investors approach sustainable investing. But how realistic are such targets around sustainability when you’re investing in emerging markets and I'm thinking around issues, around availability of data, supportiveness of local regulation and also the relevance of a developed-market mindset on sustainability for emerging markets. Could this be troublesome, Wim-Hein?

WP: Well, troublesome; not only that, but also very challenging. And it gives you opportunities as well. As a fundamental investor, it gives a lot of opportunities. ESG, sustainability is booming in emerging markets as well.

EM: In all regions?

WP: No, not in all regions, it depends. But it's extremely important in all our elements in the process around building a portfolio in emerging markets. So what we do from a sustainability angle is in a nutshell, from a country angle, we punish less-behaving countries. So that is top down, right? So countries like Russia, China, they get punishment in our valuation models. So we increase the weighted average cost of capital of every Chinese and every Russian company in the universe. So that comes with a lot of less risky elements in your portfolio automatically, right. And with less weight in the portfolio.

So we went into this huge humanitarian disaster in the Ukraine with a relatively low position in Russia, in Russian stock, which is a tremendous value haven. It was hugely cheap. It was the cheapest market in the universe. I say ‘was’, because it's off the map. It's off the investment map as we speak now. So that's over. But we still have that sustainability angle and focus on all emerging companies, with that ‘punishment’, so to speak. I call it punishment. If you do not behave very well.

EM: But you are skirting the question around data and data availability and transparency in your markets.

WP: I would like to move away from the data focus because there's so many data in the world of sustainability which is important, which is gaining in importance. And we look at them and we scrutinize these data. But more importantly is what do you do with it in your valuation models, in your fundamental analysis of a company? And there it is crucial to step away from the data and speak to management about their future investment plans. Where are you going to spend our capex? What do you make on that capex in terms of returns? Is it in sustainable areas? Do you still invest, are you planning to invest in coal? That's a no-go for us, etc. etc.

EM: So it's very much a face-to-face approach here, the feel you get from those management conversations.

WP: Yeah also, and also reading reports about the companies, annual reports. There's a lot you can get out of them from a sustainability angle.

MV: I strongly agree with that. One single number does not capture the whole ESG profile of a company. For our specific strategy many of the companies that we look at, and invest in, are software-based companies, that means that, first of all, their carbon footprint is very low. So that means that overall, the strategy scores well on the 'E' side. When it comes to 'social', many of our companies are creating new markets, new opportunities for people, and in a way also help very much on that social development side.

So a lot of our focus, because ESG is a core part of our investment ethos, a lot of the focus then goes to the governance side. So as a minority investor, am I aligned with company management and the major shareholders? And then you come to that same analysis that Wim-Hein just discussed where you want to punish bad behavior and want to stick to the good behavior.

EM: Wilma, this reference to the word 'punish', so that means just reducing weight as opposed to divesting away from such stocks, although I'm sure there must be extreme cases, how do you do it?

WG: Yeah, so I think there's quite a big discussion going on in this area of divesting and engaging versus voting. And what I think the divesting part is very visible for investors. If you exclude companies or you tilt towards more sustainable stocks, it's very visible. You can see that directly back in your portfolio, while what's going on on the engagement side or the voting side is much less visible, but probably at least as important, right? Because here is actually where shareholders have direct influence on companies. So we also recently did an extensive research project to this. We actually looked at the voting behavior of asset managers and we looked at a decade of voting data, more than 20 million observations.

And what we found in that research project is that very interestingly, but maybe also somewhat worrying, is that, on average, asset managers often vote against environmental and social proposals. And although that has somewhat increased through time, it's somewhat better now, it's still below average. And we see this especially for large managers and for passive managers, despite more appetite for sustainability over the years. So this is I think quite a concern. So I would encourage also investors to ask your asset manager, how is being voted in these areas, especially in these environmental and social areas. And actually you can also use publicly available information for that. So ShareAction recently also published a paper, they call it 'Voting Matters', where they rank over 50 asset managers, the largest managers on especially these type of topics over 2021. And so you can also have a look at how your manager is actually scoring on that.

EM: I want to round this off by pushing you on the issue around regions within emerging markets. Where do you see, from a company perspective, and that includes the governance issue that you mentioned, where do you see the best behavior, for want of a better word, or the best awareness and access to information? Michiel.

MV: I don't have a clear-cut answer for you. What strikes me is when we talk to our companies, that more and more we are getting also approached by the companies themselves to ask us as investors, as western investors, as Robeco, because of Robeco's strong pedigree on this front, what we think and can you help us further enhance this? So that is also very much related to that engagement point you were making, Wilma. And I'm a strong believer in that dialogue. So clearly many emerging markets companies are behind, if you will, but are willing to learn and enhance and get better. So I see across the board improvements, for sure. And I think we are here also to help and reach out ourselves.

WG: And I think we don't only see differences between regions in terms of sustainability. Also, if you look at different factors, we also see that some factors score better on sustainability than others. So to give an example on the negative side: often value strategies are more exposed to carbon. So they have actually higher carbon emissions than average. And that's of course because value strategies typically have higher exposure to asset-heavy companies and sectors like energy or utilities, materials, which actually have higher carbon emissions. So that's also why in general if you look at value strategies, quant or non-quant, that you might find that these strategies have higher emissions actually than the market.

And the question is actually whether that's necessary, whether it's actually necessary to take that risk on board to capture that value premium. A couple of years ago, we also did research to this and we looked at this group of value stocks. And we split that into stocks with low carbon emissions and high carbon emissions. And if you need to take this carbon risk on board, you would expect that these high-carbon value names actually also have a higher return. But we found that's not the case. In fact, it was more the opposite. So the low-carbon-emission value stocks, they actually have at least similar returns. So this is very important for investors. If you want to capture that value premium, you can actually better buy these low-carbon-emission value stocks.

EM: What does the future look like? Listening to you It sounds like a thrilling time to be an emerging market investor. You still need to be pretty strong, have strong hands. Where do you see the future? Wilma?

WG: In general, we find that there is a trend for investors to… less for one-size-fits-all solutions or approaches, but more for customized solutions. And we see that in the area, for example, choices for the universe, you can think about investing in all emerging markets or maybe separate allocations to China versus the emerging markets ex-China, but especially in the area for sustainability. And also here we find that the solutions need to be future-proof because also for investors this can change through time. What is now being found as sustainable can be different in a couple of years' time. So I think it's good for investors to check with their managers. What are the possibilities on tailor-making these portfolios and for asset managers to also be ready for this, to make sure that they have an infrastructure ready, to be able to answer this demand and customization in terms of research, data, tooling, to be ready for this demand for customization.

EM: And the customization makes sense given that what we said earlier, it's such a complex universe, so you might want to slice and dice things differently.

WG: Yes, indeed.

EM: Wim-Hein, you sound excited, you refer to the valuation discounts. Where are you headed?

WP: Well, I would like to make a distinction between short-term outlook and long-term outlook. The short-term outlook is uncertain, however you look at it, given the geopolitical challenges we're facing right now. So short term, I'm sort of cautious. But you should start to grab these markets in your portfolio. As you are very underweight, you should build your exposure now at these attractive valuations. And long term, again, very long term, the world is getting less US-centric and that is where emerging markets fit the bill. So it's going to be more EM-centric and in one way or the other, you have to translate that in your portfolios, in your equity portfolios. And then there should be room and there should be growing room for EM in a global equity portfolio. Currently, it's 15% of the of the total global equity pool. 15 is emerging, which doesn't make sense from a sort of where is the balance of these economies and these countries and these political blocs. So in that sense, 15% is way too little. But let alone that pension funds and institutional investors go to that 15%. That moves the needle already hugely in terms of asset price increases.

EM: So Michiel, an opportunity waiting to happen. But you clearly you have to know what you're doing.

> 'The underlying fundamental trend, in our view, is strongly in place. And you can see that in the results, but not yet in the stock prices. And that's what we're waiting for. But that's the vision that we have'

MV: As always, Erika. We come from this slightly differently. But I strongly believe, because I mentioned that we look for that next generation of internet users and the companies that cater to them. We've seen that whole process unfolding, back in the late nineties, 2000 in the US, later we saw it unfolding in China. You have big local champions that come to the fore and they create massive amounts of market cap. Now we're looking at emerging markets and we see the same process unfolding for us yet again. So for me, it's kind of a repeat of something that we've seen before. And of course, there are short-term interventions that can cause hiccups in stock prices, but the underlying fundamental trend, in our view, is strongly in place. And you can see that in the results, but not yet in the stock prices. And that's what we're waiting for. But that's the vision that we have.

EM: Well, time will tell if you are right. Thank you so much for joining me. It's been lovely seeing you, hearing your perspectives.

Guests: Thank you.

EM: Thank you to Wilma, Michiel and Wim-Hein and thank you to our listeners. Thanks for being part of this conversation. We'd love to hear from you, so please send us your comments, feedback and suggestions to podcast@robeco.com and you'll find all of our podcasts on your favorite podcast platform as well as at Robeco.com.

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