MAM Insight No. 8

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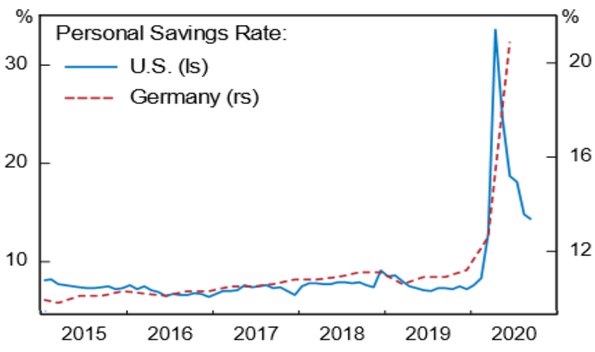
November 24, 2020

Value’s Time to Shine

It is premature to think that the Covid-19 situation is resolved. The winter season in most of the Northern Hemisphere still has a long way to go. After a strong run in financial markets in November 2020, some volatility is to be expected. Yet, vaccine news are encouraging and confirm our view all along that pre-Covid-19 GDP growth trends will resume by 2022. What makes us particularly optimistic is the pent-up demand built-in today’s economy. This crisis differs from previous ones thanks to pro-active State intervention to subsidise certain levels of income. The US and German personal savings rate have shot up dramatically over the past few months **(Chart 1)**.

Chart 1. Personal Savings Rate (US & Germany)

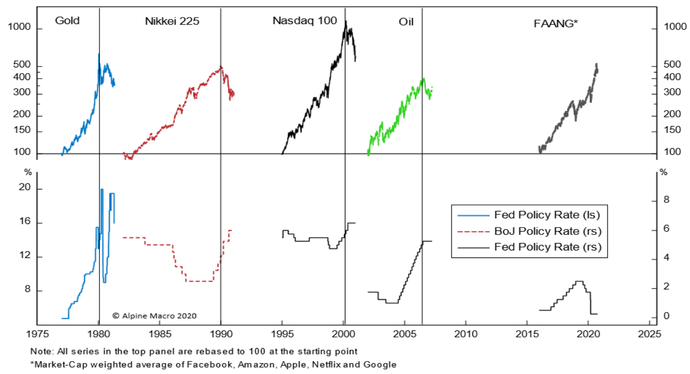


Source. Alpine Macro

As the outlook brightens, these savings will find their way back into the global economy sooner or later; especially in areas that have been hard hit over the last year such as travel, tourism, and other non-essential consumption items. When thinking about the current cycle, we may have to assume that we are in the “early” phase of the economic recovery. Looking back at the early 1920s, the world just survived a World War I and the Spanish Flu. Yet, the post-quarantine and post-wartime '20s brought an explosion of prosperity and innovation for close to a decade (It came to an abrupt halt in 1929). A similar pattern should continue to support global stock markets. What about valuations you may ask? The MSCI US Index is trading on a 22x 2021e Forward PE multiple. This is expensive, but still a -15% discount to the 26x peak multiple reached in 2000. Then, we need to consider that interest rates remain low and will remain anchored until 2022-2023. Looking back at 40-years of correlation between interest rates and valuations, a move higher in P/E ratios is not inconceivable. So what will stop this bull market and when? All Bubbles are pricked by tight money and rising rates **(Chart 2)**.

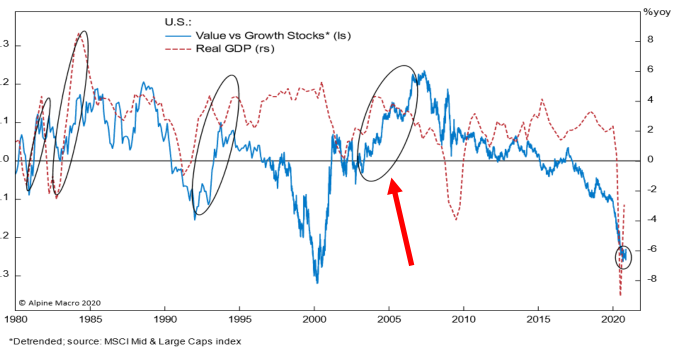
Chart 2. History of Market Bubbles & Interest Rates

Source. Alpine Macro



What does it mean for financial markets? We expect 2021 to be a good year for risk assets. However, some of yesterday's leader may become tomorrows laggards. We are not calling for a 2000-style crash in Tech stocks, instead we believe it is "Value's time to shine". The pick up in economic growth will push longer-term US bond yields higher. US 10-Yr inflation expectations retraced all of their Covid-19-related losses to reach back their January 2020 level of 1.78%. Yet, back then, US 10-Yr bond yields were at 1.80% vs. 0.85% today. As long as this trend does not become a market headwind in itself, it is undeniably more positive for "value" stocks whose valuations are less sensitive than "growth" stocks to rising interest rates. Historically, "value" stocks often outperform "growth" throughout economic recoveries **(Chart 3)**. The 2003-2006 period is a good proxy. It followed the tech-bubble burst and 9/11 terror attacks. The US Federal Reserve kept interest rates low for an long period of time and ended "behind the curve". Throughout this period of market prosperity, "value" outperformed "growth" stocks by 20%. However, it came to an abrupt halt when interest rates finally rose and burst the US housing bubble.

Chart 3. US Value/Growth Stocks vs. Real US GDP Growth



Source. Alpine Macro

What does it mean for portfolios?

Value-investing is core to our DNA. The potential return of this investment style is good news. So, what are we implementing? We are initiating an allocation to the iPath CAPE US Schiller ETF and increasing exposure to Emerging Market equities. We will incrementally build on to these positions when the market pulls back over the winter period.

US Value: Shiller Barclays CAPE US ETF

The Cyclically Adjusted Price Earnings Ratio (CAPE) was invented by Robert Shiller in 1988. This valuation metric looks at Price-Earnings ratios over longer time periods (i.e. 10-20 years). The iPath CAPE US Shiller ETF tracks a rules-based equity index. A monthly sector selection seeks to identify value opportunities. In order to identify potentially undervalued sectors, the 11 sectors of the US economy are evaluated to identify five that appears to be the most undervalued ones on a CAPE basis. Then, an additional screen eliminates one of the sectors with the lowest price momentum on a trailing 12m basis. Afterwards, the index is equally allocated at 25% to each of the remaining four sectors, which includes any of the following: Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrial, Materials, Real Estate, Information Technology, Communication Services, and Utilities.

The iPath CAPE US Shiller ETF has USD 250Mn of assets under management with a total expense ratio of 0.45%. In 2020, it rose by +13.4% **(Chart 4)** , thus beating the S&P 500 Index by 3%. The largest "value" focused ETF managed to beat the main US benchmark by 3%, despite not having exposure to any of the FANG stocks. It is a very compelling argument. Looking back to 2016, an "early cycle" economic year conductive to "value" outperformance, the iPath CAPE US Shiller ETF rallied by +18%, 2x the return on the S&P 500 Index. We believe a similar scenario can occur next-year with an initial target for the investment vehicle of $200 (+17% upside).

Chart 4. iPath CAPE US Shiller ETF (Weekly)

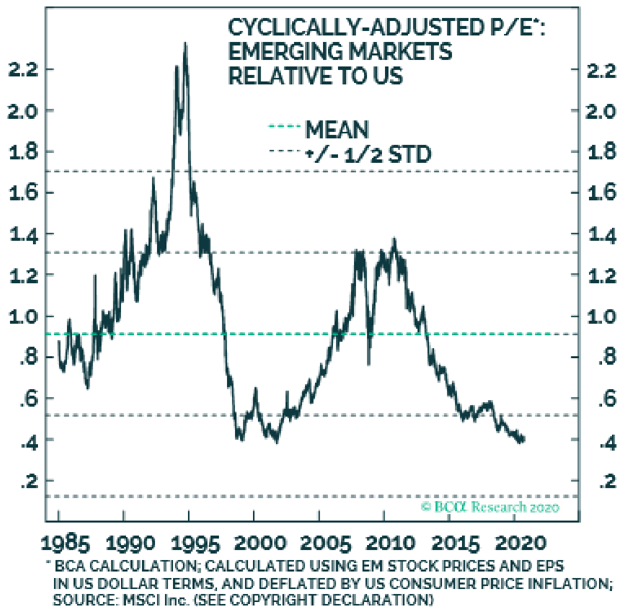
Source. Bloomberg, MAM Research

Emerging Market Equities

In recent years, structural headwinds weighted on the growth of emerging market ("EM") economies such as the 2017 cyclical downturn, 2018 trade tensions, and 2019/2020 Covid-19 pandemic. This led to a significant underperformance of EM equities. Relative to the US, EM equities trade on a 2 standard deviations ("STD") cheap CAPE ratio **(Chart 5)**. The last time such low level was reached was back in 2001, when EM equities begun their outstanding +250% outperformance, relative to the S&P 500 Index .

While we continue to expect the pandemic to weigh on the pace of the recovery in the near-term, the situation seems to be improving across a larger set of economies. EM economies are already gaining some momentum. Many of the EM economies (excl. China) have seen a relatively strong pick up in growth with the trend likely to continue in the next-year, even before a vaccine is available. A large US fiscal deficit and accommodative monetary policies will ultimately send rates higher and the US dollar lower. This weaker dollar outlook will be supportive to emerging market equities in the cycle.

Chart 5. Cyclically Adjusted P/E. EM vs. US Equities



Source. BCA Research

While we will keep investing in the iShares MSCI EM ETF and the JPM EM Fund as core positions, we are looking to take a more granular to some specific regions when technically and cost-effectively feasible.

On the aforementioned basis, we conducted an analysis of regional equities **(Table 1)**. When doing so, we first and foremost were looking at deep value opportunities. As a result, countries like China and India already stand as too expensive and no longer offer investors with sufficiently attractive risk-rewards. Then, we accounted for the size and liquidity of each regional market and the available investment vehicles to exclude that otherwise could have been interesting to be exposed to, like Pakistan, Malaysia, and Colombia. The geological risk was also a factor in our decision process. As such, we were not confident in suggesting too many regions to investors where political instability could quickly backfire (i.e. Russia, Colombia). Finally, we took a closer look at each market's earnings and growth profile to continue to narrow down the investment universe. Five regions were retained (Chart A - ETF / Chart B FX REER):

- Brazil **Charts 6-7**
- Indonesia **Charts 8-9**
- Mexico **Charts 9-10**
- South Africa **Charts 11-12**
- Turkey **Chart 13-14**

Technically, all of these regional markets look attractive. Additionally, their respective local currencies trade at a historically deep discount on a Real Effective Exchange Rate ("REER") basis. As a result, investing these regions through USD ETFs benefits from a potential equity price rally and FX appreciation relative to the US dollar. Back in July 2020, we accurately selected Mexican equities as a strong buy opportunity. Since then, Mexican equities have rallied by over +22%.

We believe Brazil, Indonesia, Mexico, South Africa, and Turkey's equities will continue to provide valuable opportunities for investors.

Please refer to the next 2 pages to see the aforementioned Table 1 and Charts 6 to 14.

As always, please let us know if you have any questions.

Best regards,

MAM Investment Team

Table 1. Emerging Market Equities - Regional Analysis Summary Table

	Index Ticker	Region FX	Last Price	1D	5D	1M	YTD	1Y	Abs. P/B	Score	Rel. P/B	Score
Emerging Markets	MXEF Index		1,220.52	0.9%	1.6%	7.4%	9.5%	16.4%	1.46	17		
Asia Pacific												
China	MXCN Index	CNY	108.11	0.5%	2.1%	4.4%	25.5%	35.8%	1.43	16	1.21	18
Hong Kong	MXHK Index	HKD	14,949.35	-1.4%	-1.0%	8.3%	-1.8%	1.7%	-0.45	13	-2.01	7
India	MXIN Index	INR	1,473.16	0.7%	0.8%	5.5%	7.6%	9.8%	1.61	18	1.03	16
Indonesia	MXID Index	IDR	6,486.52	0.2%	2.4%	14.6%	-11.0%	-8.2%	-1.41	5	-1.92	8
Malaysia	MXMY Index	MYR	534.14	0.4%	-0.6%	5.4%	-2.2%	-2.5%	-0.88	12	-1.47	11
Pakistan	MXPK Index	PKR	316.38	-1.1%	-1.8%	-3.8%	-23.1%	-16.0%	-2.16	2	-2.39	4
Philippines	MXPH Index	PHP	1,207.53	-0.3%	2.3%	10.3%	-9.0%	-8.9%	-1.39	7	-1.66	10
Singapore	MXSG Index	SGD	1,517.26	1.5%	2.8%	11.5%	-12.7%	-12.7%	-1.17	8	-2.43	3
Thailand	MXTH Index	THB	483.55	2.4%	5.6%	21.4%	-13.6%	-13.9%	-1.55	4	-2.50	2
South Africa	MXZA Index	ZAR	1,324.58	0.5%	-1.1%	1.4%	-3.4%	-3.6%	-1.97	3	-2.30	5
EMEA												
Turkey	MXTR Index	TRY	1,533,015.00	-1.7%	0.5%	12.2%	2.0%	7.6%	-1.40	6	-2.06	6
Russia	MXRU Index	RUB	599.49	-0.4%	-1.1%	8.4%	-25.7%	-21.4%	0.47	14	-1.32	14
North America												
Mexico	MXMX Index	MXN	4,350.55	0.8%	1.4%	13.4%	-8.6%	-6.6%	-2.67	1	-2.92	1
South America												
Argentina	MXAR Index	ARS	1,609.48	1.2%	3.4%	-0.6%	1.3%	18.4%	0.89	15	0.64	15
Brazil	MXBR Index	BRL	1,623.79	0.3%	1.0%	9.8%	-31.6%	-25.0%	1.63	19	1.08	17
Chile	MXCL Index	CLP	1,098.71	0.9%	1.1%	10.1%	-15.5%	-11.3%	-1.13	9	-1.85	9
Colombia	MXCO Index	COP	428.29	1.2%	1.2%	13.8%	-38.1%	-34.0%	-0.90	10	-1.33	13
Peru	MXPE Index	PEN	1,308.81	1.4%	1.6%	7.5%	-22.1%	-19.2%	-0.89	11	-1.37	12

(10-Year Timeframe, Fwd looking)

Source. Bloomberg, MAM Research

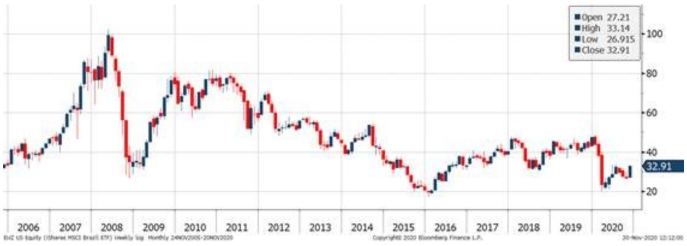
Table 1 (Cont.). Emerging Market Equities - Regional Analysis Summary Table

	Abs. P/E	Score	Rel. P/E	Score	3M EPS Δ	Score	Fwd PEG	Score	FX Std	Score	Pol. Risk	Score	Rank
Emerging Markets	2.81	18			4.7%	8	0.55	11					
Asia Pacific													
China	2.58	16	1.39	16	1.6%	10	0.95	17	1.18	17	39.22	6	17
Hong Kong	2.42	15	-0.90	12	-5.3%	12	0.64	14	0.41	14	93.13	2	12
India	2.12	14	1.34	15	6.1%	7	0.87	15	1.15	16	18.43	13	16
Indonesia	0.88	9	-2.45	4	6.9%	6	0.59	13	-0.54	11	17.07	14	8
Malaysia	-0.22	6	-4.36	1	15.6%	4	0.89	16	-1.71	6	56.12	4	5
Pakistan	-1.33	2	-3.29	2	10.1%	5	N/M		-0.79	10	7.00	18	4
Philippines	1.22	10	-0.51	14	-9.5%	15	0.54	10	1.13	15	10.64	17	15
Singapore	1.72	12	-1.49	8	-2.7%	11	0.45	8	-0.11	13	94.60	1	6
Thailand	3.04	19	2.74	18	-9.0%	14	0.59	12	1.35	18	45.33	5	14
South Africa	-1.33	1	-3.14	3	2.5%	9	0.50	9	-1.03	8	23.00	10	3
EMEA													
Turkey	-1.17	3	-2.27	6	25.9%	2	0.11	3	-2.49	1	29.69	8	1
Russia	2.76	17	-1.22	11	-5.8%	13	0.18	5	-1.94	3	31.57	7	11
North America													
Mexico	-0.72	4	-2.09	7	27.3%	1	0.21	6	-1.13	7	20.24	12	2
South America													
Argentina	1.66	11	1.64	17	-280.8%	19	N/M		-0.43	12	11.93	16	18
Brazil	0.75	8	-2.42	5	15.9%	3	0.06	1	-2.38	2	12.16	15	8
Chile	0.74	7	-1.44	9	-9.7%	16	0.35	7	-1.93	4	73.35	3	6
Colombia	-0.55	5	-1.43	10	-12.1%	17	0.14	4	-1.76	5	25.07	9	10
Peru	1.84	13	-0.76	13	-15.7%	18	0.09	2	-0.91	9	20.44	11	12

(10-Year Timeframe, Fwd looking) *(Using BF & TTM)* *(15-Year Timeframe)* *(Bloomberg Index, 0-100 scale, higher is better)*

Source. Bloomberg, MAM Research

Chart 6. iShares MSCI Brazil ETF (Weekly)



Source. Bloomberg, MAM Research

Chart 7. Brazilian Real REER (Weekly)

Source. Bloomberg, MAM Research

Chart 8. iShares MSCI Indonesia ETF (Weekly)

Source. Bloomberg, MAM Research

Chart 9. Indonesian Rupiah REER (Weekly)

Source. Bloomberg, MAM Research

Chart 10. iShares MSCI Mexico ETF (Weekly)

Source. Bloomberg, MAM Research

Chart 11. Mexican Peso REER (Weekly)

Source. Bloomberg, MAM Research

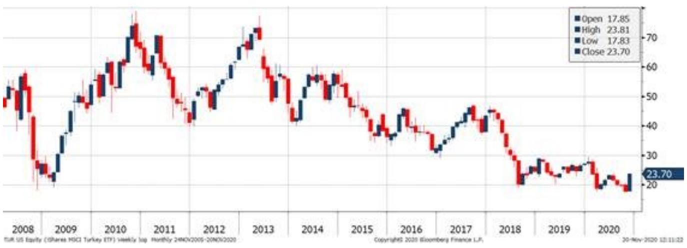
Chart 12. iShares MSCI South Africa ETF (Weekly)

Source. Bloomberg, MAM Research

Chart 13. South African Rand REER (Weekly)

Source. Bloomberg, MAM Research

Chart 14. iShares MSCI Turkey ETF (Weekly)



Source. Bloomberg, MAM Research

Chart 15. Turkish Lira REER (Weekly)

Source. Bloomberg, MAM Research

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