DuPont Capital

EQUITY STRATEGY REVIEW
JULY 2022

Emerging Markets Equity

Erik Zipf, CFA, Head of Emerging Markets Equity

Global central banks are now engaged in a simultaneous tightening of monetary conditions after badly misjudging inflationary dynamics as the world emerged from the Covid-19 pandemic. Nearly every central bank we follow in both emerging and developed markets has either increased or kept policy rates stable over the past three months, Japan and Russia being the exceptions. The tightening of financial market liquidity has caused equity market discount rates to soar, both risk free rates and equity risk premiums. Emerging market equities have fallen sharply in response. However, they have fallen less than developed market equities despite their place at the higher end of the equity risk spectrum due to a significantly lower starting valuation.

The outlook for emerging markets from this starting point is unclear. On the positive side of the equation are attractive valuations, strong commodity prices, and a Chinese economy that will likely experience a short-term rebound coming out of Covid-19 lockdowns. On the negative side of the equation are rising equity risk premiums and faltering earnings growth expectations.

The MSCI Emerging Market Index is currently valued at 11x earnings, which looks attractive in a historical context. The dividend yield at the index level is approaching 3%, which is near the upper end of the range over the past 20 years. While dividend yields could always move higher and dividend cuts are certainly possible, a 3% dividend yield provides a generally attractive starting point for future returns.

There are reasons to be somewhat optimistic about economic growth in emerging markets. China, which represents approximately a third of the MSCI Emerging Market Index, appears to be rebounding from its latest Covid-19 wave and associated lockdowns. Additionally, rising commodity prices have bolstered many emerging economies and fixed investment is beginning to accelerate in response to physical commodity shortages.

However, earnings growth expectations have come under pressure. Given the lack of earnings growth has been one of the primary drivers of emerging market equity's underperformance since the global financial crisis, this is certainly a concern. Strong earnings growth in energy, materials, and financials has been offset by earnings weakness across the remaining sectors. Our base case scenario is for earnings to moderate in the near-term but not collapse. The equity risk premium, the most important variable in the equity market valuation, is much harder to predict near-term. High financial market volatility is likely to be tolerated longer than usual by global central banks given their intent on squashing inflation, which means we could be in for a bumpy ride.

We believe the best investment strategy for the current environment is to focus on companies with strong business characteristics such as high profitability, low debt levels, and strong cash flow generation. Companies with these strong business characteristics, coupled with attractive valuations, should be in a good position to outperform in this current volatile environment and grow their earnings longer term.

Exhibit 1: Summary of Portfolio Characteristics

	DuPont Capital Emerging Markets	MSCI Emerging Markets Index
# of Securities	75	1,382
Active Share	73.0	--
Price/Earnings	10.4	11.2
P/E using FY1 Est	9.2	10.7
P/E using FY2 Est	8.2	10.3
Price to Cash Flow	11.2	19.5
Dividend Yield	3.2	3.1
Est 3-5 Yr EPS Growth	11.6	13.3
Price/Book	1.3	1.7
ROE	12.3	13.2
ROA	7.6	8.5
LT Debt to Capital	21.2	21.8
Market Capitalization	76,294	67,192

As of June 30, 2022
Source: DuPont Capital

About our firm:

DuPont Capital Management is an SEC registered investment advisor based in Wilmington, Delaware. Since the firm's establishment in 1993, we've had a long history of developing global investment opportunities in both traditional and alternative strategies across equity, fixed income and alternative investments. Our investment team structure gives us the ability to be flexible and adapt to changing market conditions. DuPont Capital's focus is delivering consistent investment management results for our clients. Our history of institutional asset management is rooted back to 1942 when our former parent company, DuPont, established a pension plan for its employees. Corteva Inc. succeeded DuPont as sponsor of the DuPont Pension Plan in 2019. DuPont Capital is a wholly owned subsidiary of Corteva and continues to manage the legacy DuPont Pension Plan.

DuPont Capital's President and CEO, Valerie Sill believes in education and diversity of experience as represented in our investment teams which are comprised of PhDs, engineers, medical doctors, and scientists. We believe their global expertise creates a portfolio implementation edge that benefits our clients.

For additional information, please contact:

Mr. William Smith
Managing Director
Business Development and Client Service
(302) 477-6204
Bill.Smith@dupontcapital.com

Important Disclosures: