Emerging Markets Equity

Particularly Attractive Currently with Many Opportunities for Active Alpha

Axiom believes emerging market (EM) equities are currently attractive and, moreover, that underlying improvements in the investible universe have enhanced stock selection driven alpha opportunities. Axiom believes:

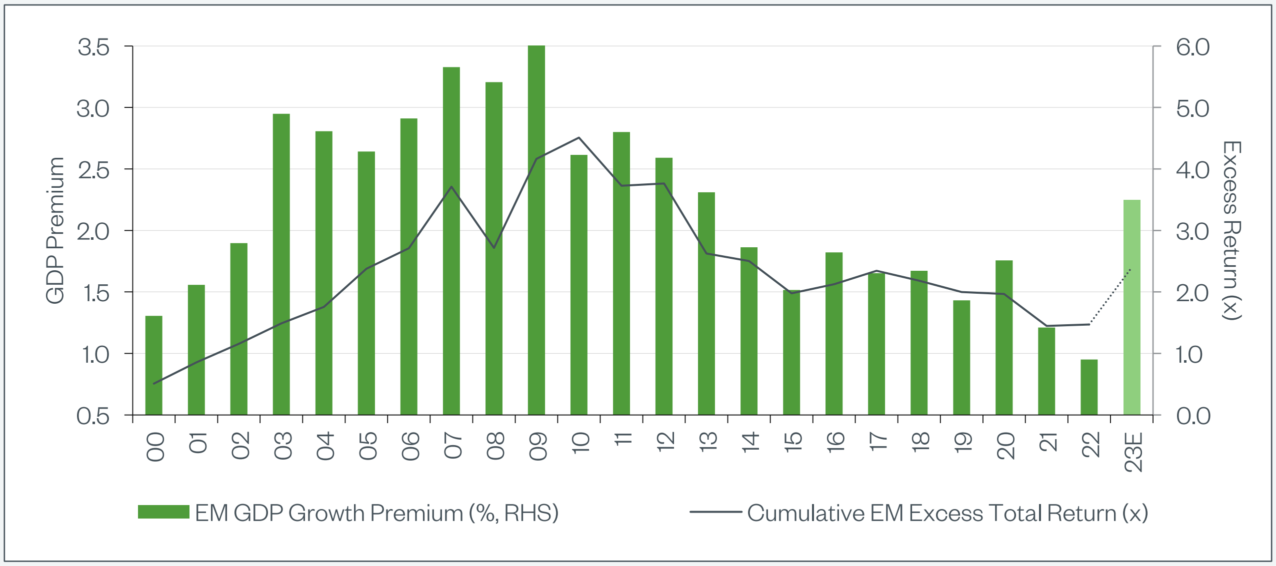
1. EM outperformance will be reinvigorated by the reaccelerating growth differential between emerging and developed markets. Furthermore, EM inflation is now falling ahead of DM inflation.
2. EM valuations are at historically attractive discounts.
3. The secular tailwinds for EM growth are likely to reassert themselves.
4. Structural improvements in the investible universe have enhanced stock selection opportunities.
5. Compelling dynamic growth themes are increasingly available across multiple emerging markets.
6. EM offers portfolio diversification with historically attractive lower return correlations.
7. EM is an essential component of responsible investing both for impact as well as alpha generation.
8. China remains an important market offering exposure to both near- and longer-term catalysts, especially uncorrelated returns, and strong stock selection opportunities.
9. An active approach to EM remains preferable given the opportunity to invest across diverse markets including over 25 countries and 11 sectors.

Since inception of our dedicated EM strategies over 15 years ago, Axiom has delivered strong net-of-fee outperformance for our investors by remaining focused on our core competence: finding and investing in the best dynamically growing companies across the emerging market universe.

1. Reaccelerating EM Growth Differential a Near-Term Catalyst

EM economies are expected to meaningfully outgrow developed markets (DM) in 2023 and beyond after the past few years of COVID-driven weakness. Further, EM's relative growth advantage over DM is expected to accelerate to 10-year highs in 2023 as DM growth is broadly expected to slow, while several key EM markets are earlier in their post-COVID recoveries.

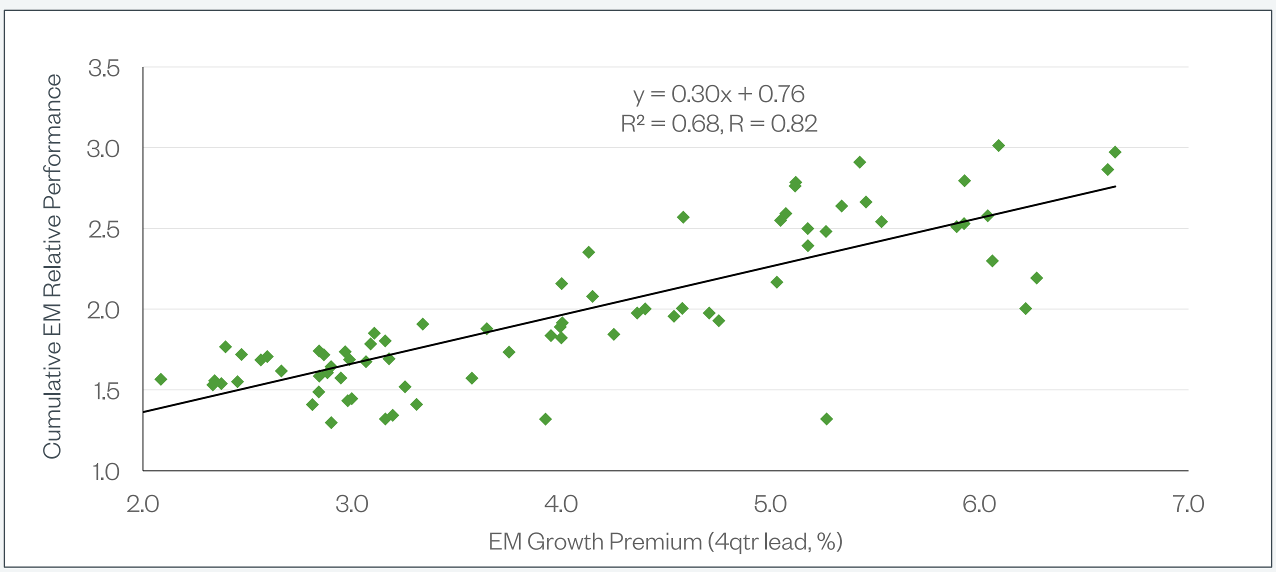
EM's Growth Premium and Excess Returns



Source: Thomson Reuters Refinitiv, HSBC, Axiom

As shown in the analysis below, there is an 82% correlation (corresponding to an R^2 of 68%) between relative GDP growth rates and outperformance by EM versus DM. The magnitude of the current gap is noteworthy because when EM real GDP growth exceeds DM growth by 3% or more, as is expected in 2023, EM tends to outperform with greater probability.

EM Growth Premium vs. Relative Performance



EM Growth Premium is EM GDP - DM GDP by quarter from first quarter of 2002;
Cumulative EM Relative Performance is EM/DM performance cumulatively by quarter from first quarter of 2003.
Source: Thomson Reuters Refinitiv, HSBC, Axiom

EM's potentially earlier monetary easing cycle may also support EM relative growth differential and equity outperformance. EM started the global monetary tightening cycle in March 2021, one year before the USA Federal Reserve's first rate hike in March 2022. EM's earlier, and often relatively tighter monetary policy, has brought inflation down versus DM. For instance, in February 2023, Brazil's IPCA inflation rate was only 5.6% YoY, lower than most developed economies during the same month, with the United Kingdom 10.4%, Germany 8.7%, and the United States 6.0%. Notably, Brazil raised the benchmark Selic interest rate to nearly 14% and started raising that rate on year earlier than the USA Federal Reserve began its tightening cycle. Indeed, emerging economies led the monetary tightening cycle, which started in 2021 with Brazil and Zambia, and EM countries are now leading the monetary easing cycle with Vietnam and Costa Rica cutting rates in March 2023, even as USA and EU continue to hike.

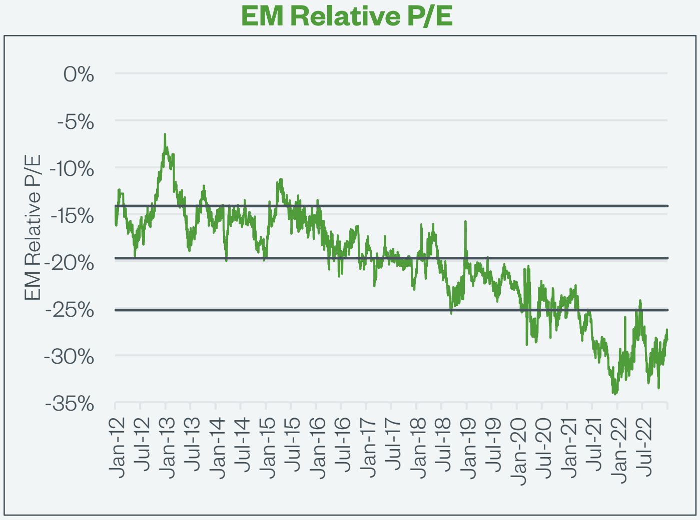
EM vs. DM Inflation

Source: Thomson Reuters Refinitiv, CLSA, Axiom

2. EM Valuation and Positioning are Also Supportive for Relative Outperformance

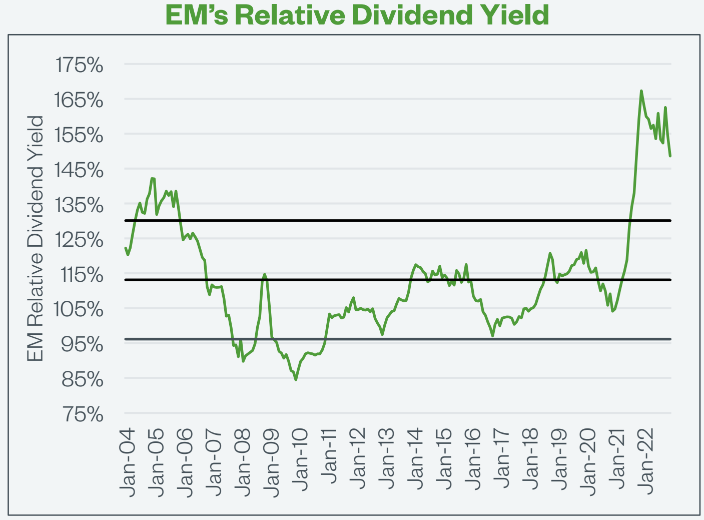
Despite the reaccelerating growth differential, EM's valuation versus developed markets is near historic lows at one standard deviation below median on relative P/E, and two standard deviations attractive on relative dividend yield.

EM Relative P/E



Source: Bloomberg, Axiom

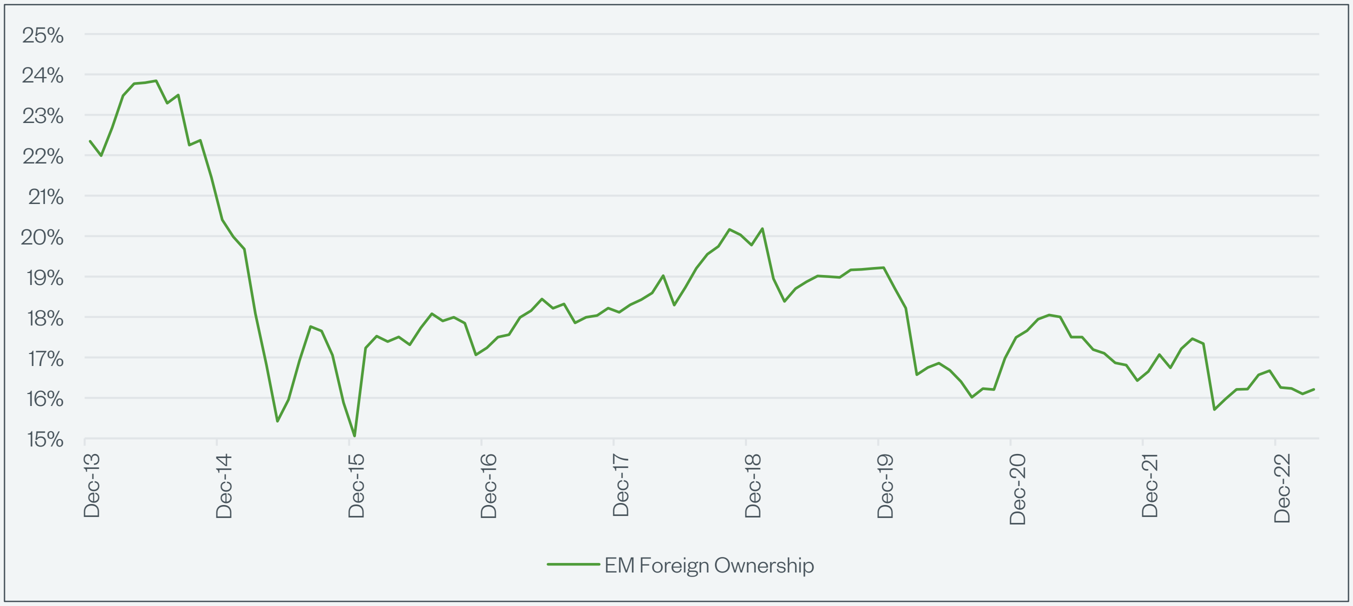
EM's Relative Dividend Yield



Source: Bloomberg, Axiom

Investors are also under-allocated to EM, with foreign ownership of the asset class at decade lows.

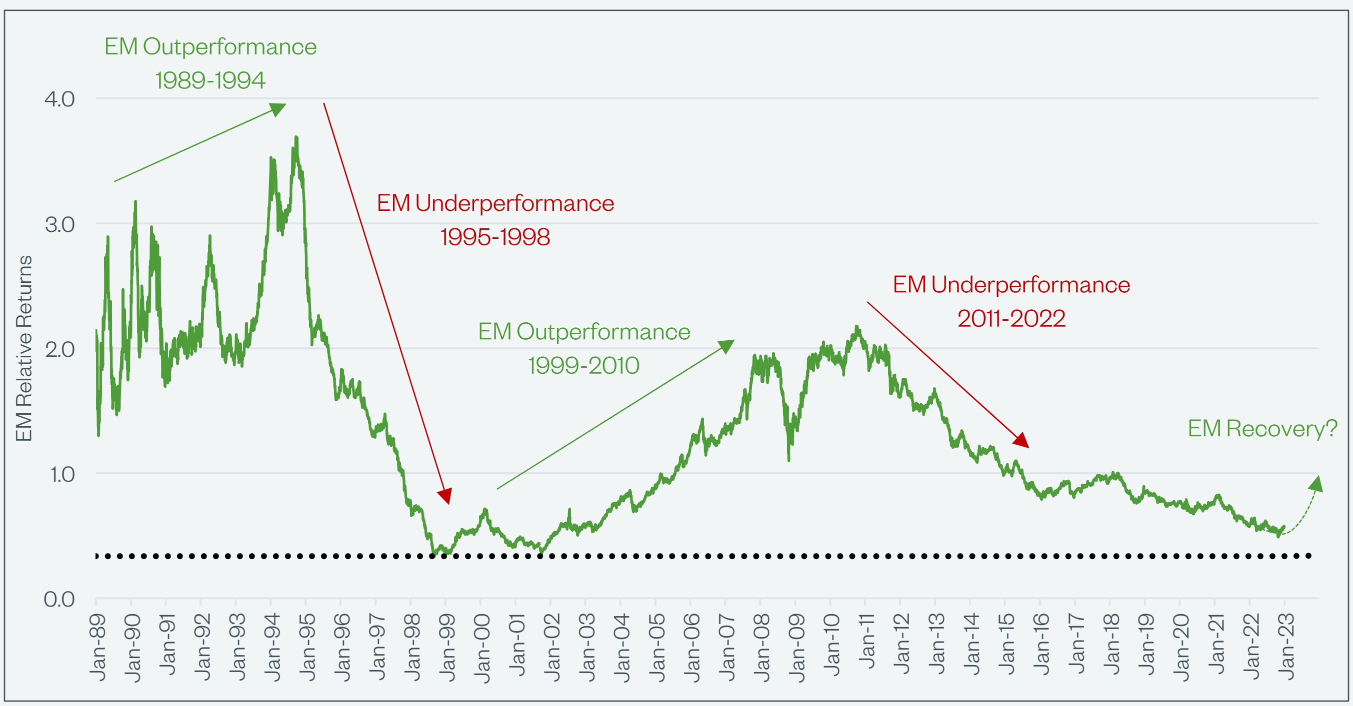
Foreign Ownership in EM Equities near Lowest in a Decade



Source: CLSA, MSCI, Bloomberg, Axiom

After outperforming from 1999-2010, EM has underperformed the S&P since 2011, the longest stretch of relative underperformance since index inception in 1987. EM's total return vs. DM is near previous trough levels. Axiom believes conditions are favorable for another cycle of EM outperformance.

EM Relative Returns

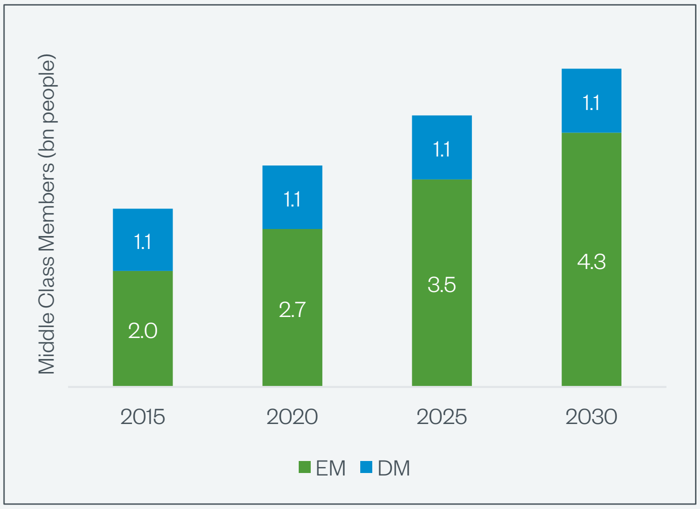


Source: Bloomberg, Axiom

3. Long-Term EM Demographic Tailwinds to Support Structurally Higher Growth

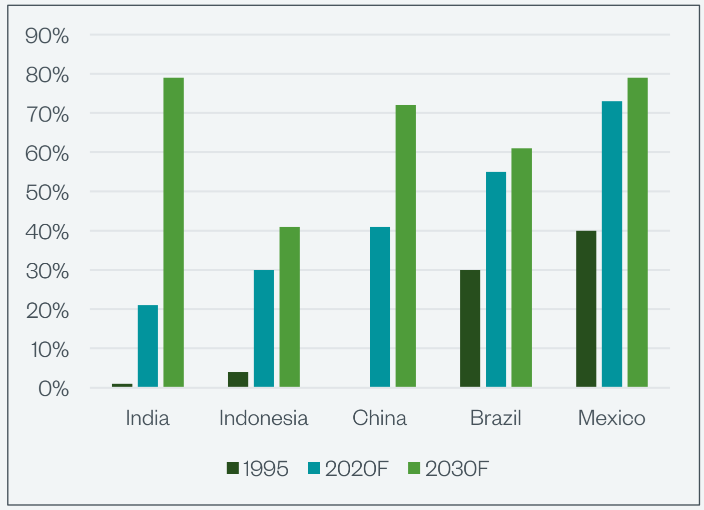
EM economies, supported by demographic tailwinds, represent one of the rare pockets of structural growth in a growth-challenged world. EM countries account for 85% of the global population and 90% of the population under 30, but only account for 60% of PPP (Purchasing Power Parity) GDP and only 25% of market capitalization. EM economies, led by India, are expected to add 1.6 billion new members to the middle class over the next decade, which equates to more than 5 people per second. The growing EM middle class should drive continued consumption upgrades, increased healthcare spending, and intensifying technological innovation for the foreseeable future.

EM vs. DM Middle Class Population



Source: Brookings Institute, Axiom

EM Middle Class Population (% of total)

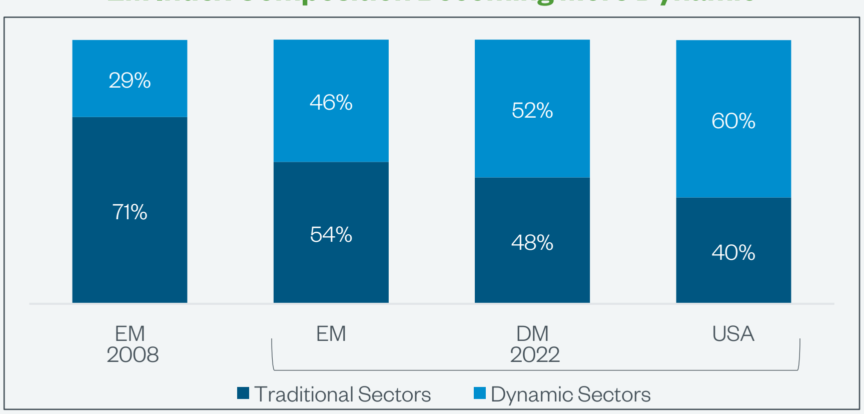


Source: Brookings Institute, Axiom

4. The Quality of the EM Investible Universe has Improved

The composition of the MSCI EM Index has improved over time. Since the Global Financial Crisis (GFC), the investible EM universe has moved from being dominated by lower-quality cyclical sectors such as energy and materials towards an increasing weight in higher-quality growth sectors including consumer and healthcare, offering significant rerating potential. There are still meaningful differences in index composition between EM and DM providing enhanced stock selection opportunities for active growth investors. Axiom expects dynamic sectors to represent over half the EM index over the next few years.

EM Index Composition Becoming More Dynamic



Dynamic: Communications Services, Consumer Discretionary, IT, Health Care
Traditional: Staples, Energy, Financials, Industrials, Materials, Real Estate, Utilities
EM is MSCI EM; DM is MSCI World; USA is S&P500; Source: MSCI, Bloomberg

EM countries have invested heavily in technological innovation, enhanced the ease of doing business, and meaningfully improved their financial situation over the past decade. Many EM economies are therefore significantly more structurally resilient. The handful of countries that are still vulnerable are more easily identified and avoided through active risk management.

In emerging regions such as the Middle East, which have historically been dominated by low-quality state-owned enterprises (SOEs), a robust IPO pipeline is introducing more dynamic growth firms to the market. Axiom's EM strategies hold positions in Middle Eastern consumer and IT companies that have gone public in the past 1-2 years.

Ease of Doing Business Improving

Rank (#)	2010	2020
South Korea	19	5
Malaysia	23	12
Taiwan	46	15
UAE	33	16
Thailand	12	21
China	46	31
Turkey	73	33

Source: World Bank, Axiom

5. Axiom Continues to Identify Compelling Long-Term Investment Themes Across EM

Axiom's research process identifies innovative businesses with sustainable operating accelerations tracking ahead of market expectations. Below are some notable investment themes that have emerged from our fundamental stock selection work uncovering differentiated growth investments in EM.

	Healthcare Spending as a % of GDP
USA	17%
Japan	11%
Brazil	10%
South Africa	8%
China	7%
Saudi Arabia	6%
India	4%
Indonesia	3%

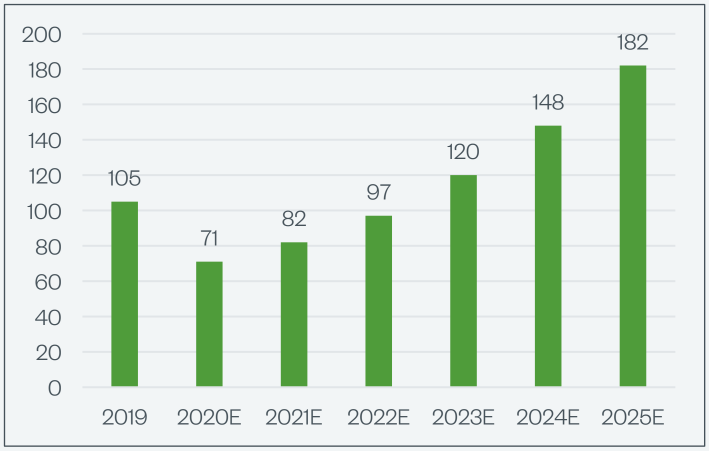
Source: World Bank, Citi, Axiom

Healthcare

Axiom has investments across healthcare subsectors in a variety of EM countries. Healthcare spending penetration is low in EM, with China and India spending only 7% and 4% of GDP, respectively, versus the USA at 17% and Japan at 11%. We anticipate there will be continuous investment in health care services, medical devices, and pharma/biotechnology. Consequently, the healthcare sector will structurally grow from just 4% of the MSCI EM index, towards the 14-16% index weight found in the USA and worldwide, and will remain an attractive growth opportunity.

Some EM countries are also now competing globally by leveraging their lower cost expertise and infrastructure. For example, Thailand's hospitals are a popular "medical tourism" destination, particularly for Middle Eastern and Chinese patients. Thai tourism arrivals increased 4x from 2005 to 2019.

Medical Tourism is $100B Global Market Growing at 20% CAGR



Source: Glasgow Research & Consulting, Axiom

Medical Procedures are More Affordable in EM (indexed to 100 = Heart Valve Replacement Cost in US)

Cost Index	USA	Mexico	Thailand	India
Heart Valve Replacement	100	18	13	1
Heart Bypass	85	12	14	5
Angioplasty	34	9	4	5
Hip Replacement	29	8	8	5
Knee Replacement	29	6	7	4
Breast Implants	6	5	2	3
Dental Implants	4	1	2	0

Source: Medical Tourism Association, Axiom

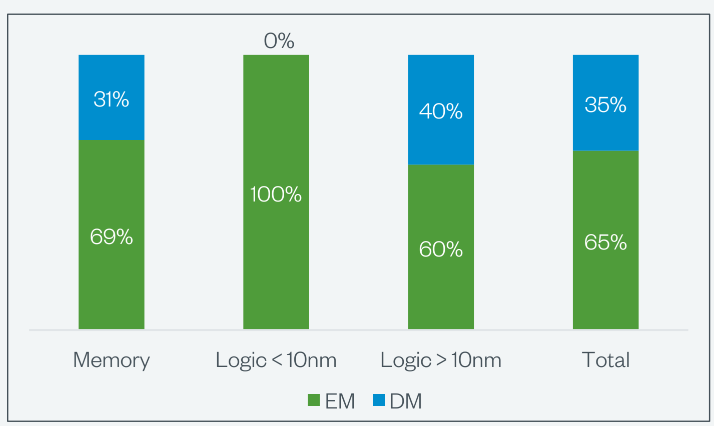
Other examples of globally competitive EM health care activities include Contract Manufacturing Organizations (CMOs) in Korea and China. These CMOs provide low cost, outsourced biologics manufacturing services for the leading pharmaceutical companies globally and, as a result, these CMOs enjoy long term growth runways. Similarly, Indian pharmaceutical companies are making inroads into developed markets with specialty drugs and other products, both as manufacturing partners for major pharmaceutical companies as well as generic suppliers.

Semiconductors and Digital Infrastructure

Advanced semiconductor chips are critical drivers of next generation technologies such as electrification of transport, internet of things, digital transformation of work, and the rapid adoption of AI machine learning. EM is an important part of the global semiconductor supply chain, with leadership in both memory and foundry. More than 90% of the world's advanced semiconductors are manufactured in Taiwan and the rest are manufactured in South Korea. Many of the semiconductor back-end and assembly processes are also completed in Asia.

We believe the semiconductor supply chain will continue to develop and strengthen in EM: the increasing difficulties in the manufacturing process and technology have built formidable competitive barriers for leading semiconductors manufacturers in Asia. Some of the world's leading semiconductor companies are domiciled and listed in emerging Asia and these companies are important long-term Axiom holdings.

EM Countries are the Majority of Global Semiconductor Fabrication Capacity



As of 2019 Source: Semiconductor Industry Association, BCG, Axiom

Supply Chain Diversification and Near Shoring

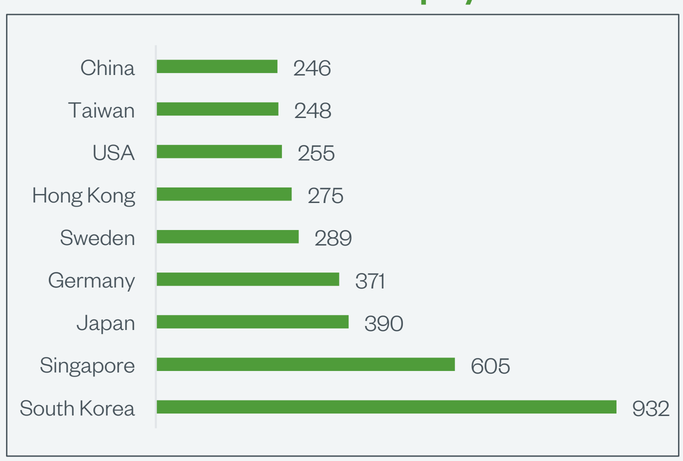
Axiom believes deglobalization is one of the 4Ds (see our webinar here) that presents structural headwinds for global economic growth supporting the long-term outperformance of growth stocks able to compound above market returns. Global supply chains are likely to continue moving out of China due to the need to diversify production locations, geopolitical tensions, ESG concerns, and uncompetitive labor costs. For example, Axiom anticipates that Mexico, Southeast Asia, and India will be prime beneficiaries of this deglobalization wave. In the first quarter of 2023, Tesla announced a $10B investment for a plant in northern Mexico and Foxconn plans to open a 100,000-person iPhone assembly plant in southern India. Axiom's EM portfolios reflect this supply chain relocation opportunity through Indian financials, Southeast Asian manufacturers, and Mexican industrial estate companies and airports.

Manufacturing Wages in Mexico Remain Below Wages in China ($/hour)

Source: International Labour Organization, National Institute of Statistics and Geography (INEGI), BAML, Axiom

The challenges of supply chain diversification will also create fundamental opportunities in China. Chinese manufacturers will be forced to move up the value chain or face increasing headwinds, creating significant opportunities for active stock selection. Axiom believes automation, testing, inspection, and certification companies will be primary beneficiaries of this trend because China still lags all its Asian peers in these areas. The gradual shift of the economy towards services will also likely be accelerated, creating interesting stock selection opportunities, including in the healthcare and consumer sectors.

Robots Per 10K Employees



Source: International Federation of Robotics, CLSA, Axiom

National Champion Brands

Retail markets across EM countries usually start informalized, with unbranded goods sold through traditional mom & pop retailers. As the economy develops and the market formalizes, modern retailing formats and national champion brands emerge. These companies generally grow faster than the overall market driven by consumption premiumization, and market share gains as leaders consolidate fragmented informal markets.

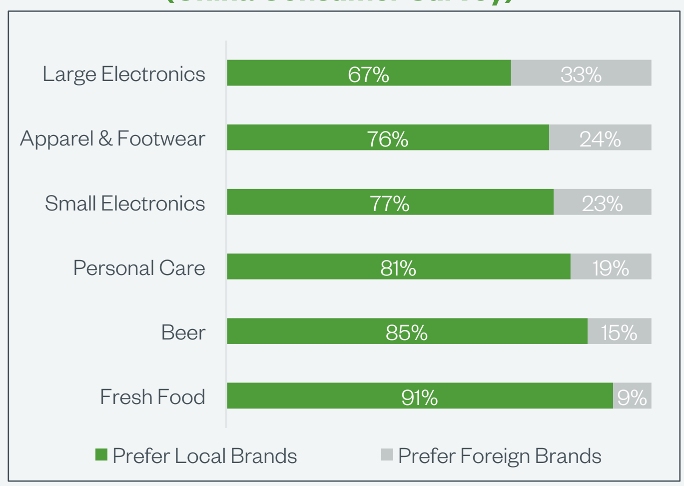
Axiom owns modern retailers and national champion brands across several EM countries.

Modern Trade is Taking Share Across EM

Source: Technopak Analysis, World Gold Council, CLSA, Nielsen, Alfamart, Credit Suisse, BAML, Axiom

China is experiencing a country-specific phenomenon in which domestic brands are taking share from foreign brands across most retail verticals. The Chinese consumer historically viewed domestic brands as low-quality due to a series of safety scandals. This perception allowed foreign brands to gain market share and charge large price premiums over their domestic competitors. In recent years, improving product quality due to strict government oversight, coupled with rising nationalism, has created tailwinds for leading domestic brands. Chinese consumers now typically prefer top domestic brands to foreign brands. Axiom's EM strategies own share-gaining brands in China across multiple consumer verticals.

The Power of Local Brands in China (China Consumer Survey)

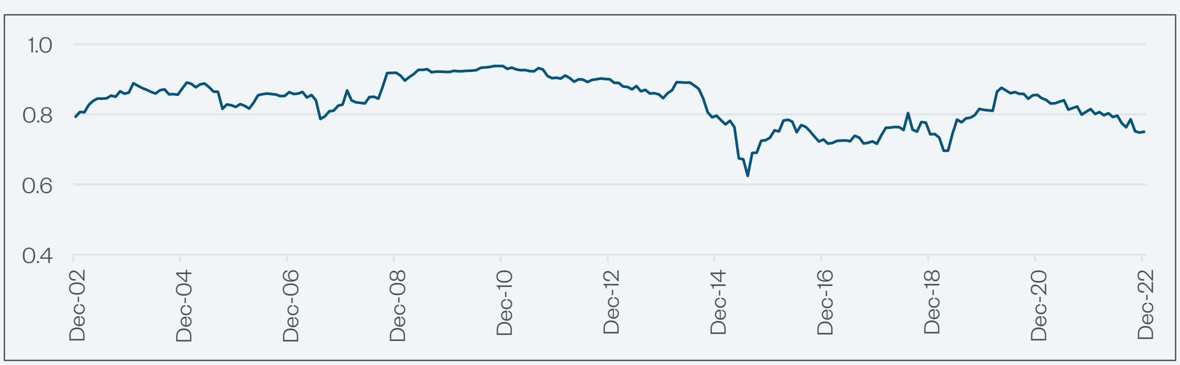


Source: McKinsey & Company, Axiom

6. EM Offers Diversification Benefits vs. Other Equity Asset Classes

In addition to benefiting from clear positive catalysts, EM also continues to offer meaningful portfolio return diversification. The diversification benefits have risen in recent years. Specifically, the EM asset class has a 10-year 0.74 correlation with DM and only a 0.67 correlation with the S&P. Over the past year, those correlations have fallen to 0.64 versus DM and 0.56 versus the S&P.

EM vs. DM Correlation*



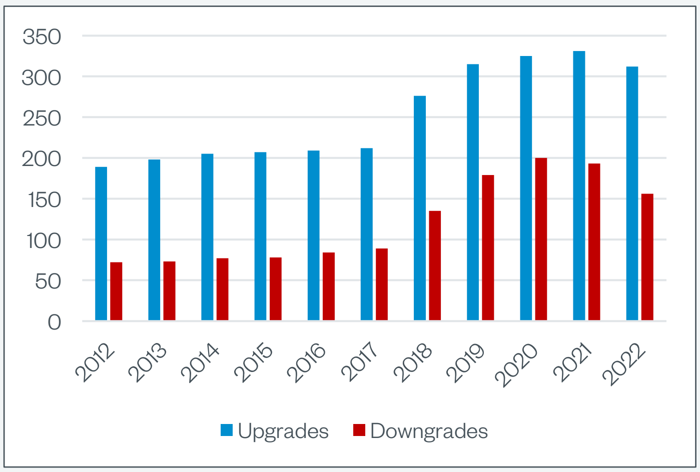
** 36-month rolling correlation of index returns, MSCI EM vs. MSCI World*
Source: Bloomberg, Axiom

7. Opportunities for EM ESG Engagement to Drive Impact and Alpha

EM accounts for 85% of the world's population and is therefore a critical component of a responsible investment program with rising opportunities for ESG engagement, both for impact as well as alpha generation. EM companies have increasingly focused on implementing improved ESG practices, become receptive to ESG engagement, and have provided enhanced transparency for investors. These trends are reflected in a persistent pattern of upgrades to ESG ratings throughout emerging markets. The MSCI EM Index now benefits from more than two MSCI ESG rating upgrades for every downgrade.

Over the past 7 years, the average MSCI score for the EM benchmark has improved from BB to BBB, while the average MSCI score for Axiom's EM strategies has improved from BBB to A.

MSCI ESG Upgrades vs. Downgrades



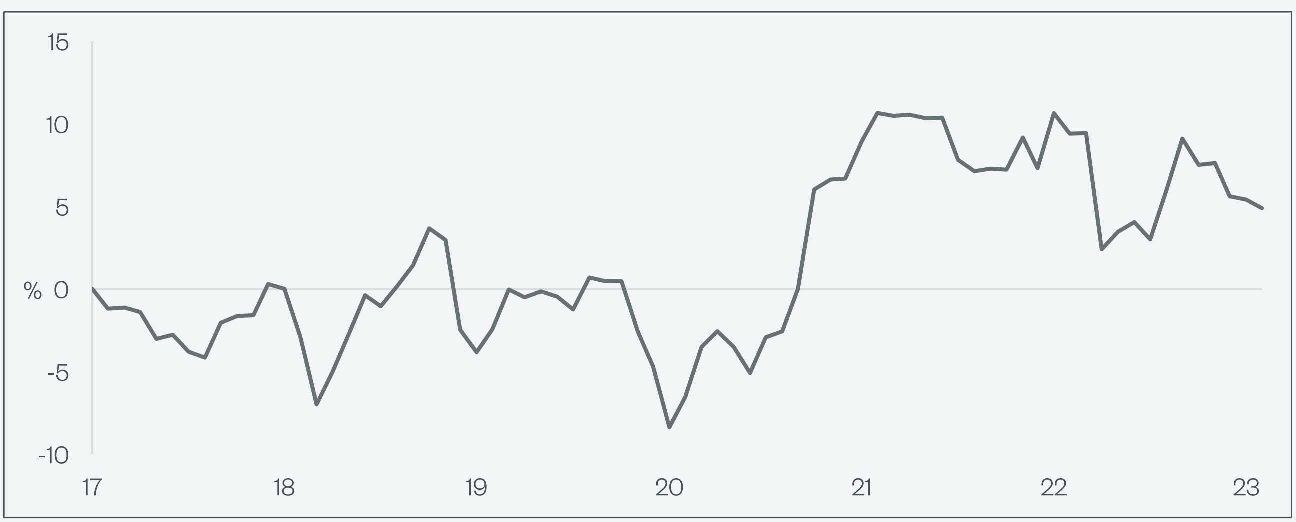
Source: MSCI, Axiom

MSCI ESG Ratings

Source: MSCI. Axiom

ESG has become an opportunity for alpha generation. Rising ESG performance is associated with positive returns.

MSCI EM: ESG Returns

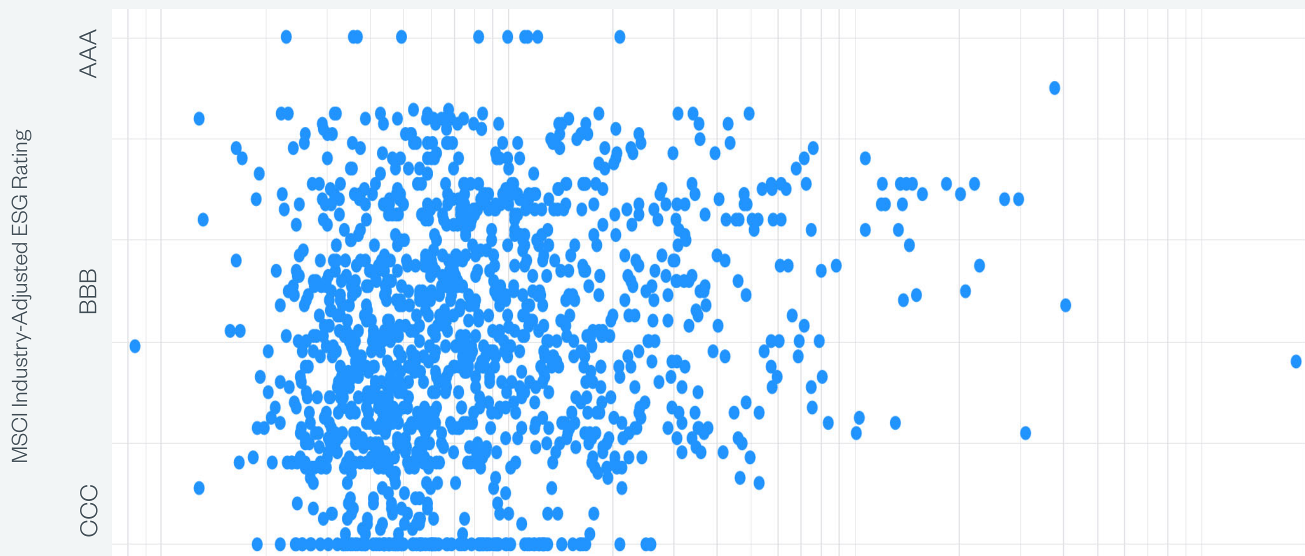


Source: MSCI, Standard & Poor's, FactSet, Refinitiv, Credit Suisse

Avoidance of ESG deterioration is an important tool for risk mitigation. For instance, ESG considerations played a key role in Axiom underweighting Chinese internet companies such as Alibaba during the 2020-2021 period of regulatory headwinds sparked partially by deteriorating social alignment. Notably, we have recently started to upgrade the ESG alignment of many of those companies.

Active stock selection is key because there is a still a wide dispersion of ESG ratings with higher quality companies scattered throughout a variety of geographies, sectors, and capitalizations.

ESG Quality Widely Dispersed



Source: MSCI, Axiom

Axiom's active approach to ESG engagement is focused on advancing positive change by working with companies to implement specific, actionable steps. In 2022, we conducted over 150 such ESG engagements across the Axiom portfolios and tracked over 3500 fundamental ESG data points in our proprietary Axware research database to monitor progress. For more information regarding Axiom's definition and application of ESG investing, please visit https://axiominvestors.com/responsible-investing/.

8. China is a Dynamic Market with Pronounced Alpha Generation Opportunities; Axiom Recommends Continuing to Include China as part of an EM Allocation

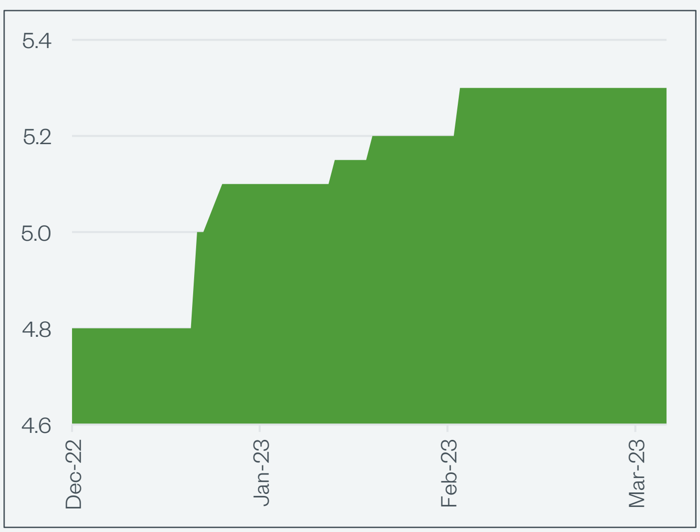
China seems poised for a rebound. Key policy and economic trends appear to be turning into tailwinds. The Chinese government has set a 2023 GDP growth target of 5%, a meaningful reacceleration from 2022 GDP growth of 3% as the economy rebounds from the extended 'COVID-zero' period. Chinese inflation is low, with February 2023 CPI of 1% and PPI of -1.4%, giving the government flexibility to ease fiscal and monetary policy to jump-start consumption and support the weakened real-estate sector.

Major Chinese state media outlets have underscored that the government is now focused on supporting growth and investment transitioning away from the prior focus on regulation and COVID. After a period of heavy-handed rule making, the Chinese government is increasingly signaling a desire to support the innovative companies that are critical to reaccelerating economic growth. Recent positive signals include January comments from a senior Central bank official that the internet platform crackdown is "basically complete", resumption of video game approvals for Tencent and NetEase, and approval of partial recapitalization for Alibaba's Ant Financial.

China 2023 GDP estimates have recently been revised higher as economic data shows an accelerating recovery for the Chinese economy and are now above the official 5% target. Road traffic congestion and subway passenger volumes are back to 2019 levels. Domestic flights are above pre-COVID levels. Property transaction volumes have returned to pre-COVID levels and property prices increased in February 2023 for the first time since mid-2021. Macau casino daily gross gaming revenue rapidly recovered to 49% of 2019 levels in 1Q23 from only 14% in 4Q22.

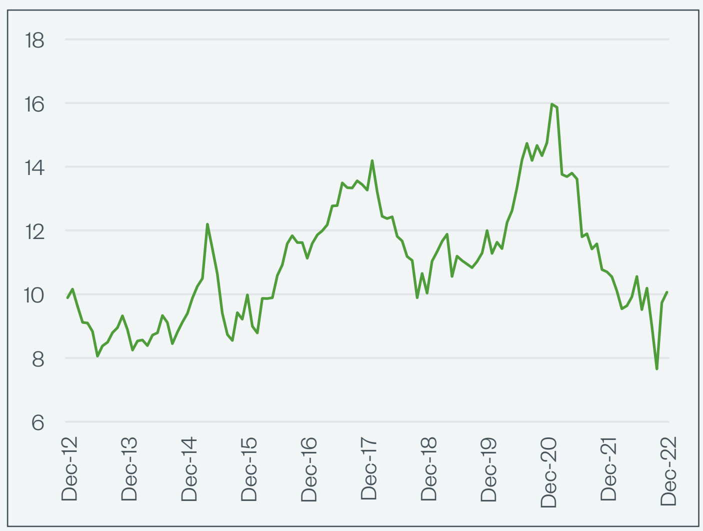
Despite the recent rally from depressed levels, Chinese equities remain very inexpensive at 10x forward P/E, well below their trading history.

2023 China GDP Estimates Accelerating



Source: Bloomberg, Axiom

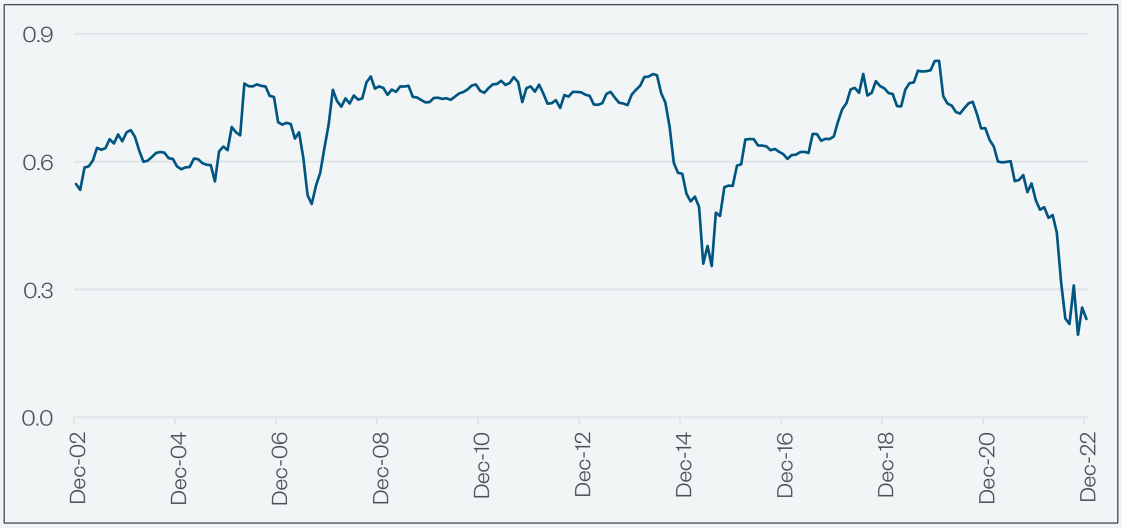
MSCI China Forward P/E Multiple



Source: Bloomberg, Axiom

From a capital allocation perspective, the diversification benefits of including China in an EM allocation are especially pronounced, likely reflecting the unique policy and economic features of Chinese markets. China market returns have a 10-year correlation of only 0.45 with DM generally and 0.39 with the S&P specifically. Rolling 3-year correlations between MSCI China and developed market indices are currently at all-time lows. Even relative to other emerging markets, Chinese returns exhibit only a 0.8 correlation, underscoring the diversification benefits of including China in an EM allocation.

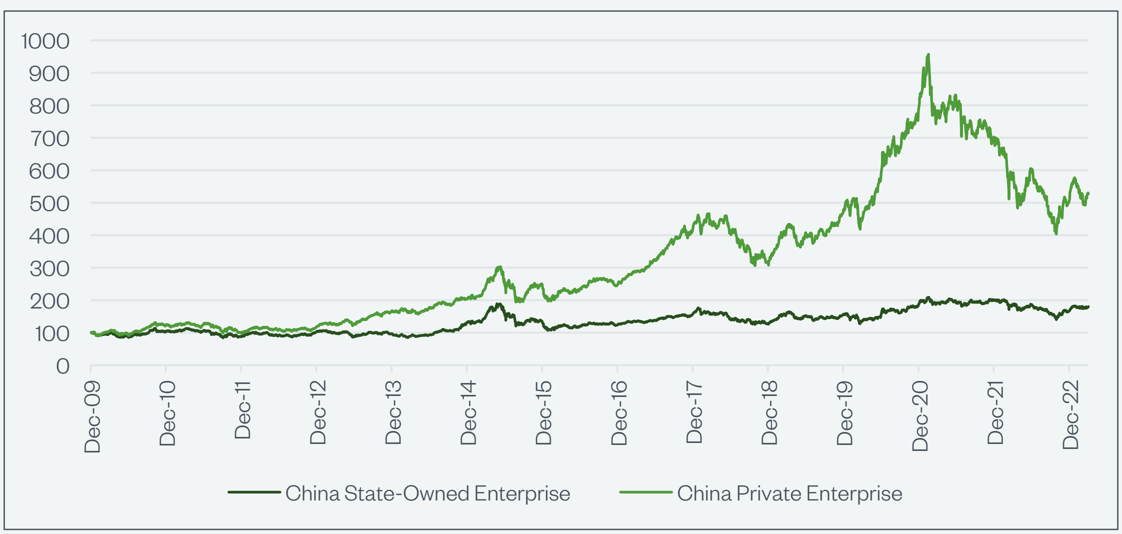
China vs. DM Correlation*



* 36-month rolling correlation of index returns, MSCI China vs. MSCI World
Source: Bloomberg, Axiom

Stock selection opportunities in China are especially pronounced due to several market-specific features. Active managers have flexibility to reduce allocation to the China market during periods when policy is a headwind to returns and when the Chinese economy is decelerating relative to other EM markets. Moreover, active managers can focus their selections on the many highly innovative companies in the technology, industrial, healthcare, and consumer sectors. The Chinese index is dominated by cyclical SOEs, which have been long term laggards.

China Private Enterprise vs. State-Owned Enterprise Performance (indexed to 100)



Source: UBS, Axiom

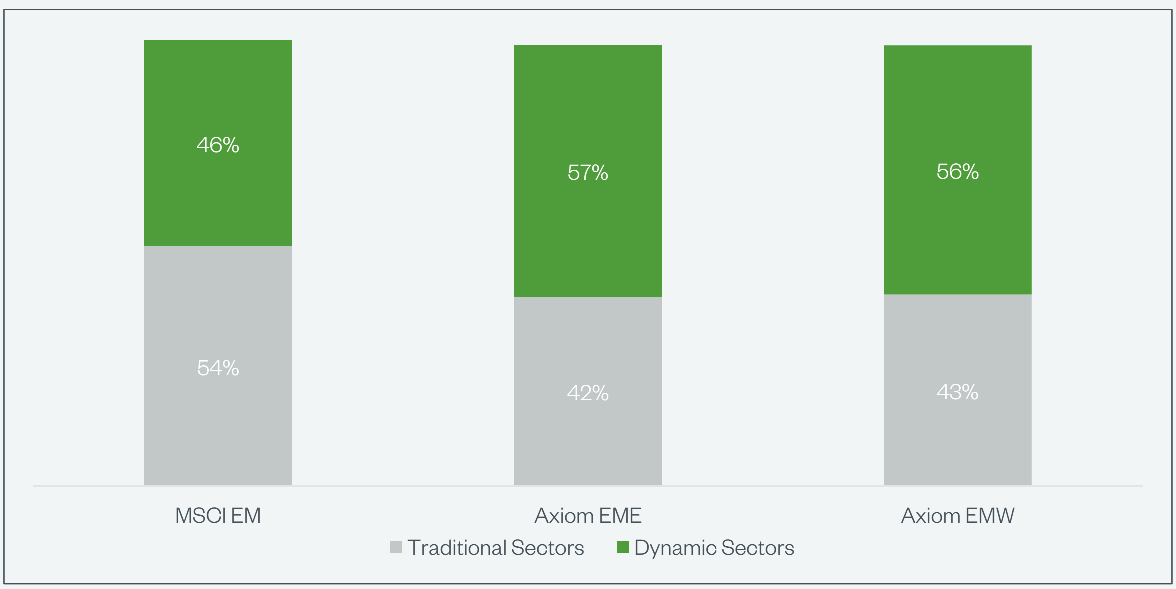
The benefits of Axiom's fundamental dynamic growth stock selection have been especially compelling in China. Since inception nearly 15 years ago, Axiom EM strategies added significant value in China, with positive contributions from both country allocation and stock selection. Regarding individual client preferences with respect to China allocations, Axiom is able to accommodate the full range of client-specific country guidelines in separate accounts.

9. Active EM Management Drives Additional Alpha

We believe EM equities will resume their leadership in a world in which economic growth remains scarce. To capture the opportunity, a key challenge for EM investors will be navigating through 25 different countries that encompass a wide spectrum of industry dynamics, economic undercurrents, cultural backdrops, regulatory environments, and geopolitical developments. Therefore, an active approach is especially compelling in emerging markets. According to Morningstar, active EM strategies outperform their passive counterparts by 40bps per year over the most recent decade through the end of 2022 on an asset-weighted basis. Passive strategies must be invested in EM index constituents that may not be good representations of the long-term EM growth opportunity. While the MSCI benchmark composition has improved, more than half remains lower-quality traditional sectors. Notably, 45% of the MSCI EM benchmark is SOEs versus nearly zero SOE exposure in the MSCI developed benchmarks. SOEs are typically long-term underperformers, as these entities are generally run for employment or other policy-driven reasons, rather than for maximizing minority shareholder returns. Axiom is overweight the most dynamic sectors in the EM benchmark and minimizes SOE exposure, focusing only on those SOEs undergoing positive change.

Axiom's active stock selection approach has enabled our experienced EM team to identify underappreciated business accelerations and invest ahead of the curve in attractive EM equities while managing risk. Since the inception of our EM strategies, Axiom has delivered strong net-of-fee outperformance for our investors.

Axiom is Overweight the Most Dynamic Sectors in MSCI EM



Dynamic: Communications Services, Consumer Discretionary, IT, Health Care
Traditional: Staples, Energy, Financials, Industrials, Materials, Real Estate, Utilities
Source: MSCI, Bloomberg, Axiom

Conclusion

Axiom believes investors should consider allocating to EM equities given the near-term growth acceleration of EM relative to DM, the long-term EM Growth tailwinds, the favorable valuations, the historically low correlations, and the wide range of attractive stock selection opportunities. Please reach out to our Client Partnerships team at ClientPartnerships@axiom-investors.com for more information.