ROTHKO

MONDRIAN INVESTMENT PARTNERS LIMITED

Emerging Markets Opportunities in the World of Trumpanomics

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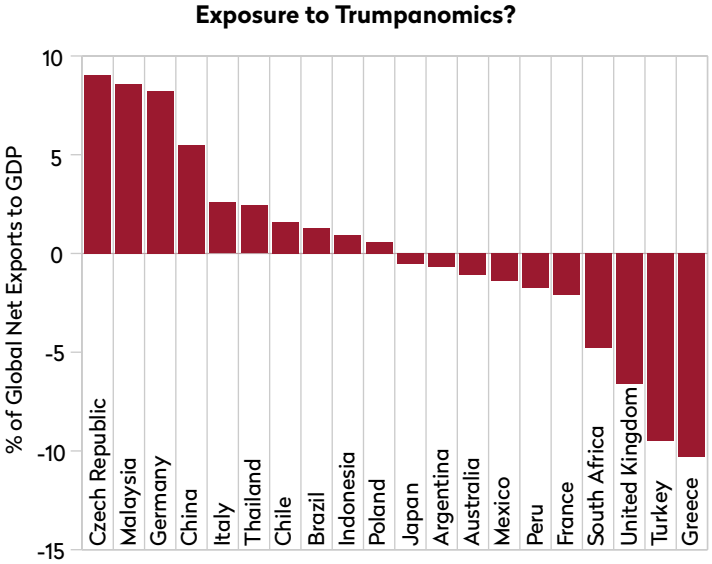
Donald Trump's economic policies are a basket of conflicting indicators for EM investors that will cause continuing volatility as the market oscillates between these contradictions. The oxymoron of protectionism alongside US reflation, driven from infrastructure spending and inappropriately low US rates (see our October note) creates areas of risk and opportunity that we believe Rothko will benefit from. We review the macroeconomic picture, discuss the precarious position of "Emerging Markets middle classes" in the context of historical precedent and conclude by describing the fundamental stock profiles we feel will be most resistant and robust in generating a continuous US$ income stream into the future.

"Trade Exposed" Economies

While a simple view of global trade identifies the economies most exposed to a protectionist driven fall in trade (see Chart 1), the situation is far more complex. For example, though China appears to be one of the most exposed major economies to net trade in goods (>5% GDP), it is important to note that country stock markets are highly heterogeneous. As we will come on to see later in this piece, there will be winners and losers in EM from US protectionism and reflation. Rothko, a fundamentally driven systematic investor, seeks to pinpoint these winners. In fact, Rothko remains neutrally positioned to China, exposed to names our models have identified as robust in this new environment. Furthermore, the Rothko "dynamic migration" model is continuously monitoring the market, ready to take advantage of any broad rebasing of prices. We feel Rothko can benefit from the new economic realities.

Chart 1: Virtuous Villians: Net Exporters



Note: 2015 Net of goods exports and imports as a % of GDP.

Source: Capital IQ, Rothko Investment Strategies.

Submerging Middle Classes

The depression era "Smoot-Hawley" Tariff Act (1930) may have seemed a good way to protect US jobs but history judges the subsequent wave of protectionism it triggered as a disaster for global trade that materially contributed to the Great Depression. The consequences of protectionism will be very different today, not least because currencies are no longer hitched to the "gold standard", however, middle classes will be hurt by the imposition of trade barriers; specifically EM middle classes. We note two points:

1. The Great Depression's protectionism arguably decimated the nascent middle classes of 1930s America for a generation; we note the uncanny socio-economic (see *www.nber.org/papers/w15142*) similarities[1] between modern day EMs and the US of the 1930s.

2. Floating currencies will dampen the effect of tariffs for exporting EM companies but those companies will still be compelled to cut EM domestic costs, affecting domestic consumers, and the increasing cost of substitution, within reciprocal tariff barriers, will also hurt domestic EM economies. A potential double whammy.

We draw from these observations that the emerging consumer will suffer disproportionately in a more protectionist world. Rothko remains around neutral to consumer sectors, but underweight to "EM consumer" centric stocks within this allocation.

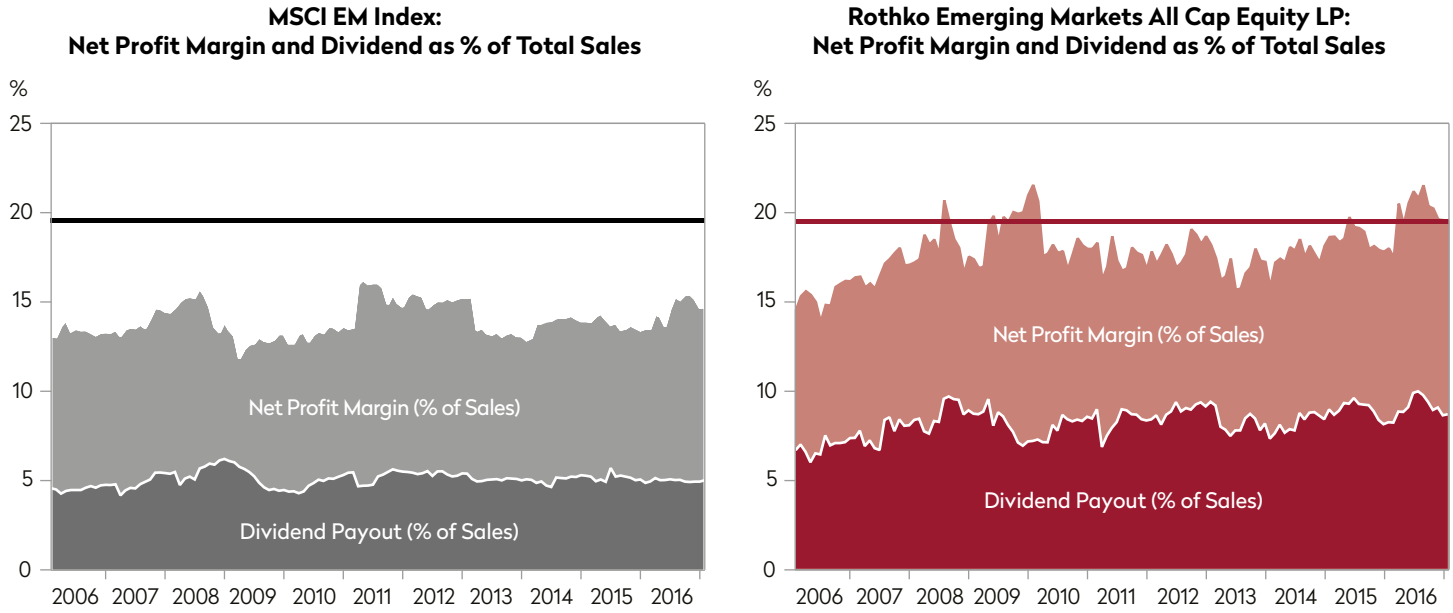
[1]The Human Development Index (HDI), making adjustment for technological progress, modern day China is arguably similar to 1930s USA on an adjusted HDI basis.

Economic Moats Versus Trumpian Barriers

In a protectionist world stocks that are "price-setters", with products that are difficult to substitute, will be more insulated from trade barriers. This feature might be described as an "economic moat" and one simple way to observe this characteristic is to view the strength and stability of a stock's US$ profit margins over time (i.e. it's pricing power). Stocks of this nature are likely to see beneficial value characteristics from any broader repricing of country risk but are also likely to continue to generate strong dollar earning streams in the future; a mispricing. A portfolio of stocks with these characteristics would most likely be identified by fundamentals and would be somewhat insulated from trade barriers. Reflation in the US would also be beneficial for these names. Rothko's models are designed to select such stocks.

Viewed through this lens the Rothko Emerging Markets All Cap Equity LP has compelling metrics. The portfolio's weighted average profit margin is around 20%, well in excess of MSCI EM Index, of around 15%. This is a running theme in Rothko portfolios (see Chart 2) and would tend to indicate a relatively strong "pricing power" of our portfolio stocks and therefore deep "economic moats". We also note the higher payout ratio of Rothko's stocks would be better insulated by these higher margins that the average stock in the index, indicating a stronger ability to absorb any tariffs before income payments. We remain overweight to fundamentally sound stocks of this nature.

Chart 2: Rothko: Higher Margin, Higher Payout



Note: Rothko data is a simulation of our models' output, indicating our strong preference for higher margin businesses with higher payout ratios. The margins are net profit margins (EPS/SPS), with outliers removed from the calculation

Source: MSCI, Factset, Rothko Investment Strategies

Protect from Protectionism: Overweight High Margin Business, Underweight EM Consumer

The Rothko strategy is diversified across country, sector and single stock and favours names with strong US dollar earnings, high margins and lower levels of financial leverage. We believe this orientation will allow the Rothko Emerging Markets All Cap Equity Fund, L.P. to continue to extract value from EM Equities in a volatile market environment, while preserving client capital in what will be an unpredictable medium term.

Disclosure

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