Quarter 1, 2022

Emerging Markets Investment Outlook

The Impact From Russia's Invasion of Ukraine

Vladimir Putin defied the West and, against hopes and many expectations, proceeded with the deplorable invasion of Ukraine on February 24th. This engendered an historic policy response and moves across global markets. Severe sanctions against Russia and politically-connected individuals were coordinated globally. The Russian equity market remained closed for 19 business days, the ruble fell to all-time lows, though it has subsequently rebounded, oil surged to $130 per barrel and spot gas prices in Europe and Asia spiked to all-time highs. The invasion has shaken people around the world with camera footage and reports from Ukraine defying most modern day beliefs. As the fiduciaries of our clients' assets, we have focused ourselves on the financial impact from this tragic war. Below we look at the various implications that are beginning to emerge.

Sanctions

Sanctions have been coordinated, severe, quickly executed and broad based. They targeted Russian banks, oligarchs, and various assets; and included restrictions over exports of technology to Russia, and investment in new issuance of Russian sovereign debt and equity. Some banks were removed from the SWIFT financial messaging system. Sanctions were also applied to Russia's central bank impacting the country's $600+ billion of foreign currency reserves which limits Moscow's ability to stabilize volatility in the ruble and economy. This led the Russian central bank to hike interest rates from 9.5% to 20% and impose capital controls. The intention of sanctions is to damage the Russian economy, with the hope that Putin will begin to lose support domestically, limiting his ability to continue with the war.

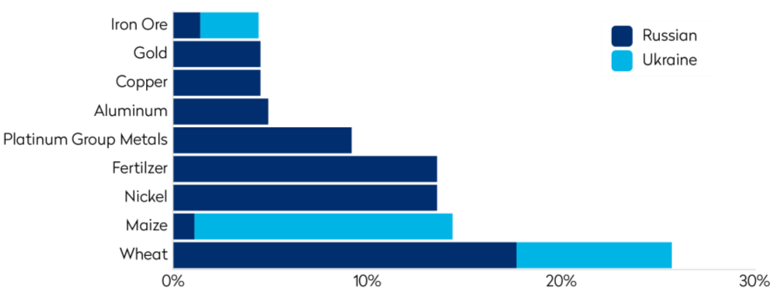
While the local stock market has now reopened, foreigners cannot trade local securities, and ADRs/GDRs remain suspended. Therefore any shares held by foreign investors are unable to be traded, and may be so for some time. Securities held on client portfolios are being priced at zero. We hope in time to be able to realise some value for these.

Macro

The trajectory for global growth is most likely altered as a result of the Russian invasion. Most economists have lowered global growth forecasts for 2022. The global economy was already suffering from elevated levels of inflation, and the commodity price shock as a result of the conflict has only served to exacerbate price rises. The main cause for higher inflation and slower growth is linked to Russian energy supply disruption. Russia accounts for well over 10% of global energy production. It is our opinion that despite sanctions on Russian Oil, the loss to global supply from Russia will be more limited than that of gas. We expect most of Russia's oil to find its way into global markets. Nevertheless, the tension regarding energy security comes at a price and hence we expect higher prices to impact inflation for most of this year.

Inflation and hence growth will also be impacted by broader commodity price strength. Russia and Ukraine account for a large proportion of various important commodities in global supply chains such as palladium, wheat and fertilizer amongst others (see below chart). The knock on effect of prices rises here can be profound in the short term.

Russian and Ukranian commodity exports (% share of world exports, 2020)



Source: Comtrade, Mondrian

Mondrian Investment Partners Limited

Fifth Floor, 10 Gresham Street, London EC2V 7JD, UK • Telephone +44 (0) 20 7477 7000 • Fax +44 (0) 20 7776 8500 • www.mondrian.com

The price of everything from semiconductors and baby formula to grains and steel had already shot up in the wake of the pandemic, forcing many central banks to begin a shift from trying to stimulate growth to fighting inflation. The war has now also damaged supplies of staple resources such as potash, neon gas and maize from Russia and Ukraine, worsening the inflation outlook.

Central Banks will therefore have to balance the needs to keep inflation in check while not wanting to stunt growth too much with higher interest rates. The longer the conflict drags out, the more likely it is that we witness an inflationary driven growth slowdown.

Global and EM Equities

The crisis is a low direct earnings risk for most global corporates, although within Europe there are some companies with a mid-single digit to low double digit proportion of revenues from Russia which will need to be largely written off for now. Domestic Russian banks, followed by European banks with local legal entities in Russia are the most exposed to risk resulting from sanctions.

Indirect risks are likely to be more substantial, including -

- Slower global growth and consumer spending due to higher oil and food prices
- Negative second order effects through Europe
- Supply chain distortions - particularly as the war has coincided with a significant rise in Chinese Covid-19 cases
- Credit and asset write downs
- Cybersecurity risks
- Tightening monetary policy

The impact on emerging markets is mixed. Of course we have experienced the complete loss of Russian assets from the benchmark. The index position before the crisis was just shy of 3% and hence the year to date MSCI EM return of -7% includes this loss. Your portfolio was slightly underweight Russian equities.

Elsewhere, the markets more linked to commodity prices have fared well. The Middle East, South Africa and Latin America have posted strong positive returns so far in 2022, in the region of 20%+. We have benefited from an overweight in Latin America, particularly Brazil and Peru. This has been mostly offset however by an underweight to South Africa and zero exposure in the Middle East which we believe is overpriced and should mean revert as we expect commodity prices to retrace somewhat over time. In Asia, Indonesia bucked the general trend of negative returns, benefiting as a commodity exporter and gaining 8.2%. Most of the larger Asian economies - China, India, Korea and Taiwan - however are commodity importers and have lagged. Although this is as much due to continued worries for China in light of heightened geopolitical concerns and growth fears from Covid-19 cases rising.

Conclusion

As long term value investors, the majority of stocks we own do not require strong growth to justify their prices, and hence even in a global growth slowdown we would expect the portfolio to be more resilient. Furthermore, given our long term disciplined process, we expect and forecast most commodity prices to normalize somewhat from current elevated levels and hence build our portfolios with that in mind. Therefore, our core positioning remains largely unchanged. We maintain an underweight to the unattractively valued Middle East, and continue to believe that China offers exceptional value post a 35% relative underperformance versus the rest of EM over 1 year.

Like everyone, we hope from a humanitarian perspective the conflict ends soon. The longer it persists though, the greater uncertainty and volatility one should expect in financial markets. We will continue to adopt our disciplined valuation process to protect and grow your assets as best possible.

Disclosures

Views expressed were current as of the date indicated, are subject to change, and may not reflect current views. All information is subject to change without notice. Views should not be considered a recommendation to buy, hold or sell any investment and should not be relied on as research or advice.

This document may include forward-looking statements. All statements other than statements of historical facts are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," "expect"). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results to differ materially from those reflected in such forward-looking statements.

This material is for informational purposes only and is not an offer or solicitation with respect to any securities. Any offer of securities can only be made by written offering materials, which are available solely upon request, on an exclusively private basis and only to qualified financially sophisticated investors.

The information was obtained from sources we believe to be reliable, but its accuracy is not guaranteed and it may be incomplete or condensed. It should not be assumed that investments made in the future will be profitable or will equal the performance of any security referenced in this paper. Past performance is not a guarantee of future results. An investment involves the risk of loss. The investment return and value of investments will fluctuate.