METIS
GLOBAL PARTNERS

METIS INSIGHTS

APRIL 2019

Metis Global Partners believes in the consistent application of valuation-driven decisions, free of behavioral biases, and grounded in the unique drivers of 60+ global industries

THE VALUE IN EMERGING MARKETS TODAY

Executive Summary

Many investors seek out Emerging Markets ("EM") for long term opportunities. But the notorious volatility of EM can provide a rough ride in the short-term. The good news from a value perspective is that periodically volatility can provide entry point opportunities with the potential to boost long-term returns substantially.

We believe that we are now at one of those times. Put simply, even with the recent bounce of 1st quarter, prices are down and EM valuations are unusually attractive.

- Valuation spreads are at extreme levels for only the fifth time in the past two decades.
- Each of the previous four occurrences was followed by meaningful outperformance by EM value stocks.
- Value stocks in every EM sector are cheaper than both their long-term averages and their developed market counterparts.
- Profitability of EM companies has risen steadily over the past three years, with an especially rapid rise in the profitability of the deepest value stocks.

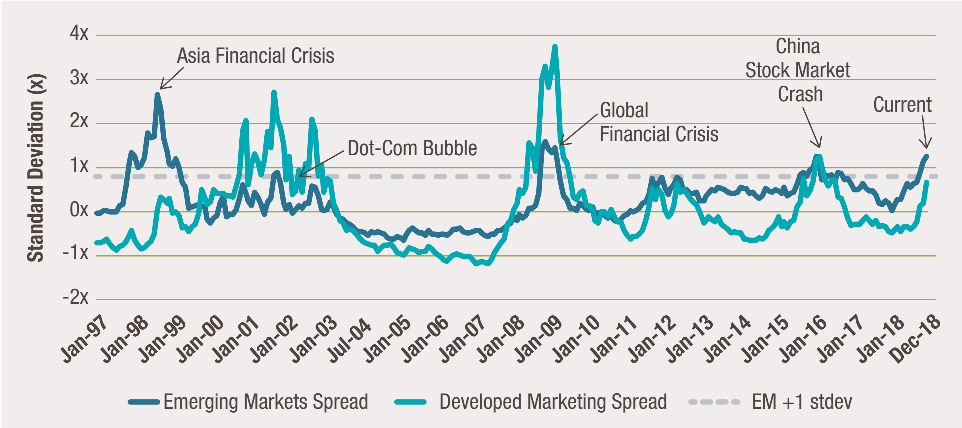
We believe, this combination of lower prices and improving fundamentals provides the opportunity in 2019 and beyond. Certainly, EM stocks had a challenging year in 2018. The rise in the dollar, US interest rate hikes and oil prices all pressured the markets, while geopolitical tension, especially between the US and China, also created jittery conditions. The MSCI Emerging Markets Index finished the year down -15%, even worse than the -9% decline in the developed MSCI World Index.[1]

When Uncommon Valuation Spreads Create Uncommon Return Potential

Valuation spreads for the top quintile of stocks exceeded one standard deviation from their long-term average at the end of 2018 — this happens rarely. In the period shown in **Exhibit 1** (since 1997), it has happened just four times previously. Two of these followed EM events (the Asian Financial Crisis of 1998, and the Chinese stock market crash of 2015), and two followed events of global scale (the dot-com bubble of 2000-1 and the Global Financial Crisis of 2007-8).

[1] www.msci.com

Exhibit 1: Valuation Spreads of the Cheapest Quintile of Stocks Relative to Market Average
EM Valuation Spreads Rarely Exceed One Standard Deviation from Average
(January 1997 - December 2018)

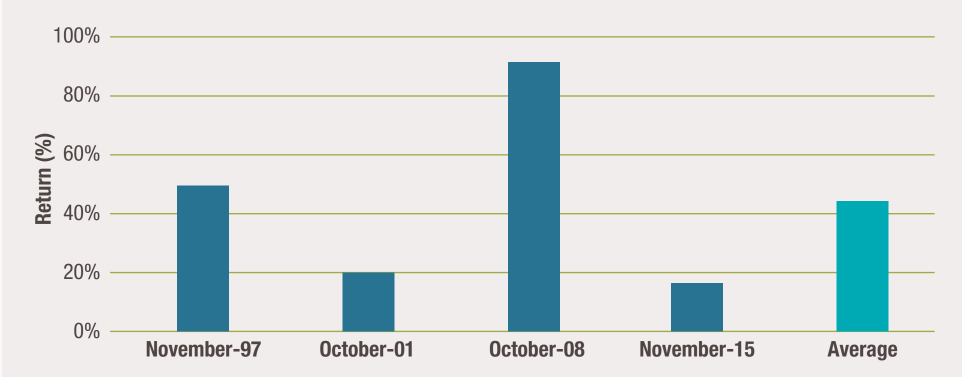


Source: Metis Global Partners, Empirical Research Partners Analysis. The valuation spreads between the top Q1 (cheapest stocks) and the market is expressed in standard deviation. The valuation metric is a blend of four valuation factors: Free Cash Flow Yield, Gross Cash Flow Yield, Trailing Earnings Yield and Price to Book. The market is a proxy of MSCI EM Universe aiming to capture 80% of the market cap in each country.

“this combination of lower prices and improving fundamentals provides the opportunity for 2019 and beyond”

Subsequent twelve-month returns for the value quintile exceeded the market benchmark after each of these events. As shown in **Exhibit 2**, these excess returns ranged from 16% to the 92% surge that followed the Global Financial Crisis. The average of these four gains was 44%.

Exhibit 2: Twelve-Month Excess Returns of the Value Quintile After the EM Valuation Spread Exceeded One Standard Deviation from Average (1997-2018)



Source: Metis Global Partners, Empirical Research Partners Analysis. The valuation spreads between the top Q1 (cheapest stocks) and the market. The valuation metric is a blend of four valuation factors: Free Cash Flow Yield, Gross Cash Flow Yield, Trailing Earnings Yield and Price to Book. Returns are calculated as the top Q1's 12-months forward relative to the emerging market. The emerging market is a proxy of MSCI EM Universe aiming to capture 80% of the market cap in each country.

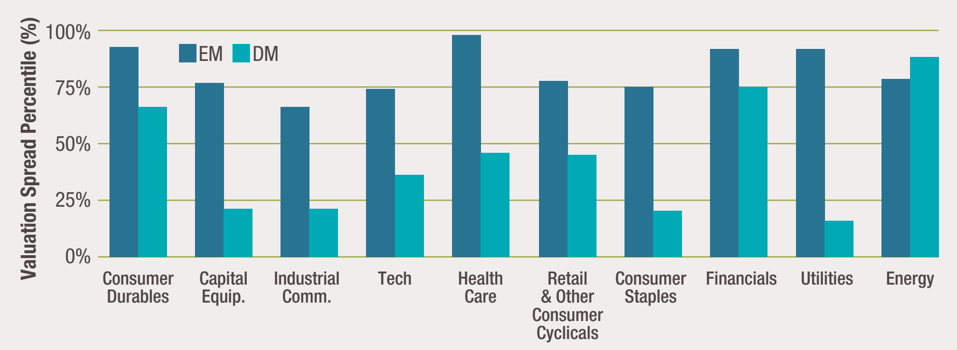
“Valuation spreads exceeded one standard deviation...this happens rarely”

Current View

The current valuation opportunities appear spread across all sectors. **Exhibit 3** illustrates the valuation spread for each sector, compared to its long-term average (set at 50 on the chart) and against its developed market counterpart. Every sector except energy is cheaper in EM (higher current percentile), and every EM sector is cheaper than its long-term historical average (which is true of only three sectors in developed markets).

> "Every EM sector is cheaper than its long term average"

Exhibit 3: EM Valuation Spread by Sector
EM Sectors are All Cheap Relative to their History



Source: Empirical Research Partners Analysis. The valuation spreads are calculated between the top Q1 (cheapest stocks) of the sector and the sector average. A comparison of the spread as of 12/31/2018 with its long-term history (since 1997), are normalized at the percentile 50. The valuation metric used to calculate the spread is a blend of four valuation factors: Free Cash Flow Yield, Gross Cash Flow Yield, Trailing Earnings Yield and Price to Book.

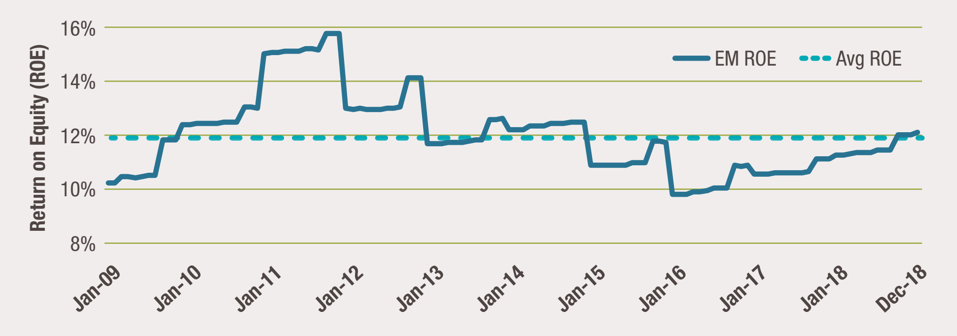
EM Fundamentals Are On The Move

Compared to some of the prior periods of undervaluation, EM macro fundamentals are generally much improved. Most EM countries have strengthened their monetary and fiscal regimes, and improved governance. The use of dollar pegs has declined, allowing markets to set exchange rates. Some EM companies have become global leaders. More broadly, EM companies have become more prudent users of debt, with more issuance in local currencies, and an emphasis on fixed rate borrowing.

> "Return On Equity of EM companies has been trending up since 2016"

The profitability of EM companies, as measured by Return on Equity (ROE) is perhaps one of the better indicators of these improving fundamentals. While ROE had declined on average in the first part of this decade, since 2016 it has been trending back up. For EM in aggregate, this measure was back to its 10 year mean of 12% by end-2018.

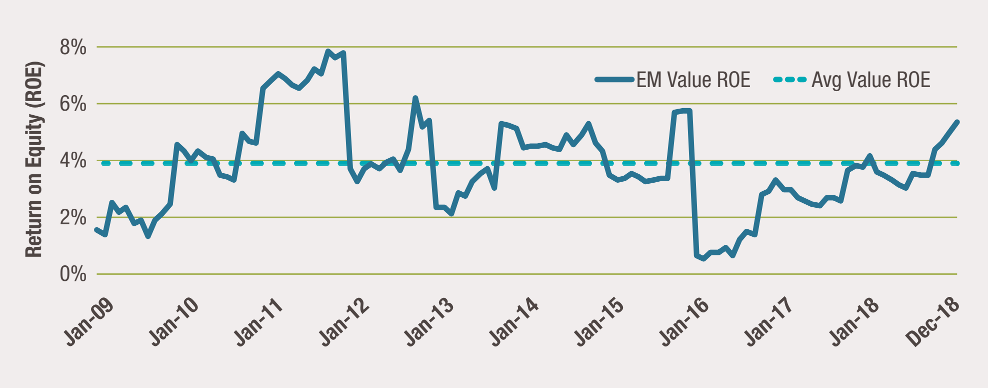
Exhibit 4a: EM Profitability has Increased Over Past Three Years



Source: Metis Global Partners, Factset, S&P Emerging Markets Large Mid Index. Average ROE is calculated on rolling-monthly basis between January 31, 2009 and December 31, 2018.

More importantly from a value perspective is that the ROE of the top value decile of EM stocks has surpassed its 10 year average of 4%, reaching 5.3% at end 2018.

Exhibit 4b: ROE of EM Value Decile has been Trending Upward Off 2016 Lows, Exceeding 10 Year Average



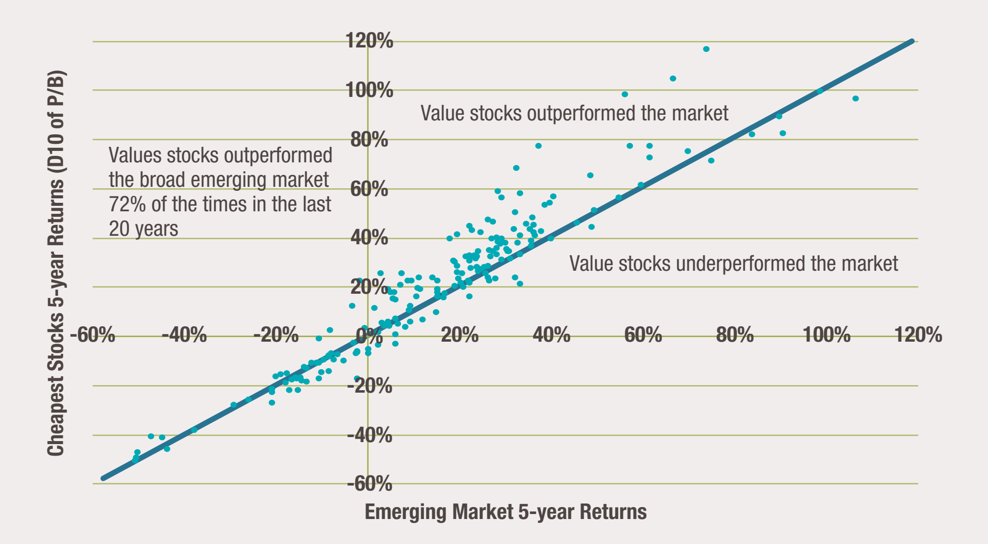
Source: Metis Global Partners, Factset, S&P Emerging Markets Large Mid Index. The average ROE for the value stocks is calculated on a rolling-monthly basis between January 31, 2009 and December 31, 2018. Value stocks are defined as the cheapest Price to Book quintile (Q5) of companies.

"Undervalued EM stocks have shown outsized performance historically"

A Recipe For Returns

Investors are presented periodically with the confluence of lower valuations and improving fundamentals, that can boost long-term returns from Emerging Markets. This may be one of those times, in our view. **Exhibit 5** illustrates that undervalued EM stocks have shown outsized performance historically. On a monthly basis, we measure the subsequent 5-year returns of the cheapest decile of EM stocks. Over the past twenty years, these outperformed the broad market almost three-quarters of the time. The most consistent outperformance came in up-markets, with outperformance by that value decile over 80% of the time; in down-markets they performed in-line on average.

Exhibit 5: EM Value Decile: 5-year Performance Relative to Benchmark Outperformance is Evident in Up-Markets



Source: Metis Global Partners, Worldscope via Clarifi. The forward 5-year annualized returns are calculated between 12/31/1997 and 12/31/2018. Value stocks are defined as the cheapest Price to Book decile (D10) of companies. The Emerging Market is defined as the 1st to 10th percentile of stocks in the emerging market region by market capitalization.

In conclusion, we would re-iterate that valuation does matter over the long-term. After the price falls of 2018, value stocks in Emerging Markets may be poised for significant outperformance. Valuations are at extremes that occur only infrequently. All sectors within EM appear cheap relative to their history, and profitability has been improving steadily for three years. In the past, undervaluation has been followed by strong returns.

-The Metis Team

About Us

Metis Global Partners is an independent, employee-, and woman/minority-owned firm focused solely on the management of global and international equity portfolios. The firm believes that the consistent application of valuation driven decisions that strive to be free of behavioral bias is the most effective way to create wealth for its clients.

The Metis Team's roots are firmly grounded in a rich history of both academic and practitioner research at the intersection of global equity markets and investor behavior. By applying global fundamental knowledge in a systematic manner to large opportunity sets, the team is able to find undiscovered value opportunities around the globe. With an average of 20+ years of investment experience, the team maintains an active research role, being responsible for numerous industry and academic publications on the topics of global markets, value investing, and investor behavior.

Please contact us at info@metisgp.com or 858-436-3030 for questions or inquiries.

Metis Strategies

International Equity

International Small Cap Equity

International Micro Cap Equity

Emerging Markets Equity

Global Equity

Global Micro Cap Equity

INDEX DEFINITIONS

S&P Emerging Markets Large-Mid Cap Index: The S&P Emerging Markets Large-Mid Cap Index is a comprehensive, rules-based index measuring stock market performance of large and mid capitalization companies from developed and emerging markets excluding the United States.

S&P Developed Large-Mid Cap Index: The S&P Developed Large-Mid Cap Index is a comprehensive, rules-based index measuring stock market performance of large and mid capitalization companies from developed markets excluding the United States.

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