

‘I’ve never been better situated’: Top EM equity PM over one and three years

Long Read: Citywire AAA-rated Lewis Kaufman explains how he has repositioned to reduce traditional favourites and how he bulked up on China at the right time.

By **Chris Sloley** / 7 April, 2020

Lewis Kaufman has something to say. And the developing world equity manager is certainly making his voice heard. During a rapid fire half-an-hour conversation, Kaufman isn’t even derailed when the line drops between San Francisco and London and powers on regardless.

‘Where were we?’ is his momentary lapse before continuing on a dissection of how the healthcare systems in China, the former BRICs and the Western world stack up. Anyone wanting to know where Kaufman is needs to only look at his numbers.

According to Citywire data*, Kaufman is the top-performing manager in his peer group, Equity – Global Emerging Markets, on a one- and three-year total return basis to the end of February 2020.

As he mentioned to Citywire last summer, Kaufman’s emphasis is on finding areas of low penetration, which means looking closely at domestic demand. This is while working around three core principles – build, preserve and reinforce – which are designed to find strong businesses with growth potential.

‘I think this framework that we’ve developed with a growth and compounding mind-set has proven incredibly valuable for staying out of some of the landmines in the asset class,’ he told Citywire at the end of March.

‘I think as we roll forward, the vast majority of people that have traditionally looked at emerging markets, or are looking at emerging markets, do so in the wrong way. I think there’s an expectation



that there’s going to be some cyclical recovery. But there is pressure and, while I’m not saying that that markets can’t bounce, I think some of these pressures that we’re seeing are structural.’

Making the move

The move that saw Kaufman swap Santa Fe-based Thornburg Investments for Wisconsin-headquartered Artisan was viewed as an intriguing mid-tier move, far from the prying eyes of the asset management giants hugging the seaboard. Five years on and Kaufman – who is now based in Artisan’s Californian base – has seen his reputation grow.

‘When I was at Thornburg back in 2009, I had been managing international equity portfolios and we decided to launch an emerging market strategy. I launched and managed that fund back in December



2009 and did so for the five years before moving and starting the strategy at Artisan in mid-2015.

‘You know, the asset class today is in some ways similar and in some ways different. At our core, we are a domestic demand strategy. We believe in low-penetration, domestic demand in emerging markets because we think that creates compounding outcomes.

‘But I would say two or three years ago, I think we hit a little bit of a wall, where these low penetration stories in the emerging markets were no longer progressing in the same way they used to,’ he said.

For a man with 35.7% in China, Kaufman was not concerned about the challenges the region faced from being the epicentre of the Covid-19 outbreak. In fact, Kaufman said, he was adding to his China exposure at the expense of other countries, such as Brazil, India and South Africa, which were systematically sold down over the past year.

‘China is different, and we’ve seen that during the crisis there and their quick response to the virus. But I think you’ve also seen it in their monetary and fiscal capacity, and I think the story goes beyond that.

‘What you see in China is a country where, yes, demographics are challenged as it’s an ageing society, but they have what I refer to as a ‘skilled labour dividend’. In other words, in 1996, just 2% of the population had some form of higher education.

‘Today 14% of the population has some form of higher education. To put that into numbers, it increased from about 20 million people to about 200 million people. And it doesn’t really matter that you don’t have a demographic dividend, because you have a lot of skilled workers.’

Looking at the immediate exposure, Kaufman said he seeks to be insulated from the wider implications of the Covid-19 downturn, which was undertaken by dropping exposure from 45% to Brazil, India, Mexico and South Africa, which is now around 22%.

‘Some areas are going to be worse and more pronounced because of the damage imposed by the coronavirus. But, what is ironic for us is we believe that we have never been better situated to deliver the types of disproportionate equity outcomes, which is how I think about the asset class.

‘I don’t think you should invest in emerging markets because you want to play a trade or a cyclical recovery. I think you should consider investing in emerging markets because low penetration has the potential to engender better compounding outcomes and create disproportionate equity outcomes. That’s what we’re in the business of finding. We’ve never been better situated to do that.’

Backing the consumer story

At present, the largest positions in Kaufman’s strategy are Alibaba, the Chinese conglomerate, as well as Indian financials giant HDFC and Sea Ltd, a Singapore-based internet company. Despite these specific positions, Kaufman operates with a pronounced emphasis on consumer stocks.

His 37-strong portfolio has 25% in consumer cyclicals, nearly a 13 percentage point overweight to the index and 19.7% in consumer defensive, which is an 11 percentage point increase on the index. This is while the likes of MercadoLibre sit within his top 10 positions.

With the US unemployment rate rising and concerns about the knock-on effect for the consumer sector, is Kaufman also sharing these fears? ‘I’m not valuation driven, I’m value driven,’ he said. ‘I look for companies that can

create value in a disproportionate way and I’m looking for companies that can sustain that value creation. So we’re not growth focused either.

‘But, we’re not looking for companies that can grow 30% for three years and then we sell and find the next one. We’re looking for companies that can create value and sustain that value creation. I think the reason that is important in a consumer context is a lot of consumer-facing companies can do that.

‘These are brands that have value that consumers can taste and touch, and we want to be aligned with that. We think there’s a resilience to that story. We could certainly invest in the investment component of GDP.’

Kaufman said the market has been difficult – ‘volatile and challenging in every way’ – but he has sought to reinforce exposure to compounding stocks where possible. This is also achieved through managing currency risk and limiting exposure to countries dependent on foreign capital.

One way he has achieved that is through focusing on developed world stocks with developing world exposure, which is why he has 25% in US stocks. ‘We invest in multinational companies that have different correlation and currency profiles are more robust, and we invest in financially sound, free cashflow generative companies that aren’t leveraged and that will have to go to capital markets at hand during a period.’

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Clarifications:

- (1) *Citywire ranking is based on the total return of a U.S. mutual fund in the Artisan Developing World Composite. The fund ranked 1st out of 812 funds for the 1-yr period and 1st out of 720 funds for the 3-yr period within the Citywire Global Emerging Markets Category as of 31 March 2020. U.S. mutual funds are generally only available to U.S. domiciled investors. Rankings, performance, fees, expenses and portfolio characteristics for the separate account will vary.
- (2) As of 31 March 2020, Consumer Discretionary and Consumer Staples sectors comprised 29.1% and 10.1% respectively, of a representative account in the Artisan Developing World Composite. Source: Artisan Partners/GICS/MSCI.
- (3) Exposure as described by Lewis Kaufman in the article refers to companies that derive a significant portion of revenue from a stated country, which may differ from the companies' country classifications. As of 31 March 2020, country weights for China, United States, India, Brazil, Mexico and South Africa in a representative account in the Artisan Developing World Composite were as follows: China 35.3%, United States 25.4%, India 5.4%, Brazil 4.2%, Mexico 0%, South Africa 0%. Source: Artisan Partners.

Investment Results as of 31 March 2020 (%)	QTD	1YR	3YR	ITD
Artisan Developing World Composite (Gross)	-7.81	7.26	11.31	9.55
Artisan Developing World Composite (Net)	-8.05	6.15	10.16	8.42
MSCI Emerging Markets Index	-23.60	-17.69	-1.62	-0.53

Annual Returns (%) 12 months ended 31 March 2020	2015	2016	2017	2018	2019	2020
Developing World Composite (Gross)	—	—	20.44	22.60	4.90	7.26

Source: Artisan Partners/MSCI. Returns less than one year are not annualized. Composite inception: 1 Jul 2015.

Past performance does not guarantee and is not a reliable indicator of future results. Current performance may be lower or higher than the performance shown. Composite performance has been presented in both gross and net of investment management fees.

The Citywire rating reference is based on a fund or multiple funds under management within the Artisan Developing World Composite and not the Composite itself. Citywire Manager Ratings are assigned by Citywire based on a review of a manager's relative 3-year performance record of one or multiple funds under management and range from Citywire+, the lowest rating, to A, AA and AAA, the highest rating. Past performance is not a reliable indicator of future results and ratings are not indicative of the current performance of any product under management. Manager personal performance quotations contained herein are prepared by Citywire and are not independently verified by Artisan Partners.

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