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## Pzena Emerging Markets Strategy Update

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As we emerge from the darkest days of the pandemic, we are seeing companies and countries perform differently based on the level of vaccine rollout, variant penetration, government response, and subsequent covid-19 waves. **Brazil** is an example of a country that is doing worse than hoped and sold off considerably in the quarter. We own several businesses in Brazil in the portfolio, all where we see company-specific drivers to recovery. They include AmBev (beverages); Itau (banking); and CEMIG and Light (utilities). During the quarter, we added to Ambev and Itau on weakness, as we believe each has a leading market position and financial strength to weather a sustained downturn. In addition, Bolsanaro's off the cuff remarks sent shudders through the utilities sector, as he intimated pricing is too high. We believe this fear is overblown and took advantage of the price weakness to add to our position in CEMIG.

Another evolving area is our **China exposure**. We continue to be underweight China in part due to our avoidance of the high-flying mega-cap tech names (e.g., Alibaba, Tencent, Meituan Dianping) that dominate the MSCI Emerging Market Index. However, our bottom-up process continues to uncover interesting opportunities. This quarter, we added Vtech Holdings, the world's leading supplier of electronic toys, based in Hong Kong. VTech has maintained above-industry margins by producing niche, low volume products. Its nimble production footprint (a must in today's trade-tense world) is also an advantage. In an interesting turn of events, Alibaba briefly entered our first quintile late last year. That said, our research suggested that, absent the hit from the Ant debacle, the company was not cheap enough for us, particularly as regulatory risk appears to be rising significantly.

We also expect **companies managing transition effectively** will continue contributing to returns. An example is Hon Hai, the Taiwan-based electronics design and contract manufacturer. Hon Hai has made significant investments to maintain its leadership position to its customers in 5G technology, automation, and electric vehicles. Hon Hai's valuation is starting to reflect investors' recognition of these investments, and we believe there remains significant upside to fair value. Now that the wave of smartphone penetration has crested, investors are looking for "what's next,"

and this quarter cheered the demonstration of Hon Hai's next generation capabilities.

Our research is also identifying more **idiosyncratic opportunities** such as VTech, which we discussed above. In addition, we initiated a position in Shriram Transport Finance in India, a uniquely positioned business that finances purchases of used commercial vehicles. This niche is largely beyond the interest of the banks, enabling Shriram to earn consistently high returns. The last few years have seen significant pain in the industry, but we expect both a business recovery as well as Shriram's growth into more rural areas to boost profits into the future. As always, the emerging market universe seems to us to be particularly rife with these sorts of unique, company-specific opportunities. To put it simply, there are a lot of rocks to turn over.

Our portfolio positioning has only changed marginally from last quarter; the portfolio continues to have a cyclical theme, as most of our positions have not yet reached fair value despite the strong run in value and our performance. **Valuation dispersion** has pulled back from October 2020 levels, though still stands near all-time highs in emerging markets. **Self-help initiatives** are paying off, as operating leverage starts to come back; POSCO and Hankook Tires are examples where earnings have been better than expected due to improved top lines and margins. Although continued cyclical recovery from the pandemic should set a strong macro backdrop over the intermediate term, we believe selectivity is critical, as not all businesses have dealt with structural change in the same way. **We believe that sustained earnings recovery for our portfolio companies will be through a combination of economic recovery and restructuring initiatives and will be a differentiator and driver of Pzena-specific returns.**

## FURTHER INFORMATION

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