Transcript

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Ken:

Hi, everybody, Ken Kozlowski, chief investment officer and portfolio manager of Equitable Investment Management. Today, I've got the distinct pleasure of welcoming Paul Vieira on our Markets and Investing podcast. Paul is the founder and CEO of EARNEST Partners as well as a self-made entrepreneur who has launched a venture capital platform and was the driving mind behind the development of Return Pattern Recognition -- an investment methodology used to screen equities.

Paul earned a BA in economics from the University of Michigan and an MBA from the Harvard Business Schools. He's got over 25 years of investment experience and along with being a minority owner of the San Antonio Spurs, he's had a great track record on two portfolios available on the EIM platform. So, Paul, thanks for taking the time to be with us today.

And I just want to welcome you. Thank you very much. And let's get started.

So let's talk about emerging markets. So why should the average investor right now pay attention to emerging markets?

Paul:

Well, I think in a couple of words, I think the prospects for returns are strong and if I told kind of a quick story; <going back> more than 15 years ago, I would be in Asia and I'd be sitting at dinners with colleagues or prospective investment candidates in terms of companies, and they would say, why are you coming here?

And I would answer, I said, well, if I was in the UK in the late 1900s and I looked at the US and I didn't go, I would be a dummy. So, if I'm in the US In the 20th century and I look at Asia and I don't go, I would be a dummy. So that's why I'm here and I and I think that bleeds into maybe three things that make emerging markets kind of attractive: there are people, there is technology and there is their valuation.

So on the people front, 85% of the world lives in emerging markets.

And you know, they create stuff, and they buy stuff. And so, the manifestation of that is you get 40% of the world's GDP is in emerging markets and 2/3 of the growth rate in the last decade has been in emerging markets. So, there's a lot of opportunity. The big opportunity set.

With respect to the people, there's an accelerant on it, which I think, is technology, Ken. And the technology point is this. Back in 2000, the Internet came about and that made information and communication ubiquitous.

And what came out of that was that emerging market economies were able to really accelerate their growth in a lot of different ways. And so you saw things like mobile commerce in both Asia and in Africa as examples.

And the result for emerging markets from 2000 and 2010 was they really beat the pants off of developed markets, right? And I think we're at another sort of tipping point and that is with the advent of AI. Because what AI does, amongst other things, is it makes expertise more ubiquitous.

And so when you look at emerging markets and you look at talent and you say engineering talent…they are far more engineers graduating from emerging markets than they are from developing markets, so they have the talent base to use the tools. They're going to use those tools for innovation and it's going to make innovation much more dispersed throughout the world as opposed to having been a little more concentrated in maybe the last 20 years. And it also is going to shrink some wealth gaps, which is going to create both consumers and capital in these emerging markets. So the second point is just around, I think technology is going to be an accelerant for good fortunes in emerging markets. And then the last thing that I mentioned was valuation.

And that always matters. And it always matters to me and my team.

Today, the valuation levels in, let's call it the US as compared to emerging markets are half. You pay half the PE and the emerging markets that you do in the US, so I think against that backdrop it's a pretty attractive time and clearly this year has been a good year in emerging markets -- it's up almost 20% on a year to date basis, which is 2 1/2 times what developed markets or maybe the US might be over that period of time. So a little bit of a longer answer, but you can tell my enthusiasm for the space and there's a lot of good reasons I think to really take a good hard look at emerging markets right now and to make it a part of your portfolio.

Ken:

And talking about your strategy, Paul, how does your firm approach, emerging market investing differently?

Paul:

Well, I think there there's a couple of universal points that I think we use that are different than some others. And then I think there's a perspective rather than getting into the line item of the investment process. I think the first is our investment team is made-up of people who came from industry, not the financial service industry, but <people who> came from the industries in which we want them to make investments. So when we look at investments in emerging markets and we're looking at companies, we're looking at them from the point of view of practitioners of people who have been in that industry, so that we can both handicap the prospects of that company against its competitors and the prospects of that company with respect to.

Say you were evaluating its technology. The first point is who we have making those evaluations is different than others. I think the second is we have a really good ground game. We've been doing this for 30 years now and so we have both our tentacles in all of the emerging markets that we're invested in and we think we get a good readout with respect to what's really happening on the ground and all the dimensions that you need to look at it, whether it be regulatory frameworks or whether it be the confidence of the people we're contemplating or all the other things that you consider.

But I think the thing that I would say from a mindset makes us a little bit different is we focus on the company and not the country; the company and not the country. And you could imagine the following if I told you that there was a high school and they had very low scores, you know, on some state or national exam.

And you say, well, I don't want anyone from that school--that wouldn't be accurate. There would still be a handful of students that were truly exceptional and that are going to do fantastic in life. And so you'd want to be able to take a look at them and make investments in them. And so that's what we do so maybe a country where people would have some issues, you could look at Argentina or something like that and you say OK, bad test scores maybe, but the reality is there are some good companies that have come out of Argentina. You know, you look at Mercardo Libre, which is the Amazon and Alibaba of Latin America, and so there are really outstanding opportunities when you focus on the company rather than solely focusing on the country and saying I like this country, I don't like that country.

Ken:

And Paul, one of the things that really impressed me about your team when we first brought you on board, and continuing to today, are the people on your team, a lot of them come from backgrounds where teamwork is very important, a lot of them are ex-military, senior leaders in the military, people that have been captains of their lacrosse team at Princeton, for example, things like that. And that really was something that differentiated you and your team from other strategies; and obviously the numbers speak for themselves, but I just wanted to mention that because that continues to be very impressive.

Paul:

I appreciate that, it's something we spend a lot of time on, trying to get the next hire and trying to hire people who we think of as a snowflake, who are a little bit different than the other snowflakes, and so we don't want to replicate the same snowflake in the room. We'd rather have people who have a lot of different experiences from the others, so that when we come together, we can get maybe a better sense of what the truth is.

Ken:

In my intro, I mentioned return pattern recognition, maybe you could spend a couple minutes just telling us what that is and how does it add value to your investment process.

Paul:

So return pattern recognition is the initial screen we use when we're trying to sort out whether we want to own a company or not. And so what can happen in investing if you don't have a screen and I'll tell you the particulars of our screen is that you end up being highly influenced by what's going on in the news today.

And when you're just highly influenced by what's going on in the news today, you can miss opportunities of companies that are ascending or companies that have great valuation levels that others are missing because they're just focused on whatever is on the television screen or in the paper. So in the first instance, it allows us to get to a universe of companies to review that popular press and otherwise wouldn't point to. I think the second thing that it does is we segment companies by industry and what we have done is we've identified the different industries have different characteristics when they're about to perform well.

So when you go back and you break up companies into a lot of different industry groups and then you say what's important for our financial service company, a bank to do well is not the same thing that's important for a software company to do well and so on and so forth. And so again, it gives us a chance to handicap.

What are those companies that are exhibiting characteristics today that are likely to suggest they may outperform in the future and we like to say that that gives us a head start because the companies that pass this screen do better than the benchmark, and then if we're a good fisherman and we can pull out the bigger fish out of this more fertile pond, then it gives us a chance to deliver better results for the people who entrust their money to us.

Ken:

And looking right now, what do you see as the most exciting opportunities in emerging markets?

Paul:

I think the first one rhymes with everywhere else, but it may be a little more amped up and the other one not as much.

So the first would be…

There's going to be $5 trillion that is going to be spent in the AI ecosystem and in the infrastructure part of it, not just the models of the big model companies that we're all aware of and that's going to have to be dispersed across the planet inclusive of we're 85% of the people.

So those companies that are supplying that infrastructure, no matter what it is, it could be coolers and cooling systems or data centers or it could be you know any matter of other sort of thing. Those companies are likely to do very well against that spend. So we're looking at that and that's pretty exciting. But I think in emerging markets there's another element which is when you look at the financial service industry and as these countries become wealthier, and as their middle class swells and you know, right now you're looking at a middle class in emerging markets, that's approaching $3 billion people, and as that swells, there's a greater demand for financial services against a backdrop of many of the historical participants not being that good with can you know customer service and also not being fast adopters to technology.

So in a mobile and digital world, with respect to banking and finance in general, when you can identify the companies that are going to take advantage of those two currents, you get a chance to do pretty well. I mean, I think, you know, we own the Indian Bank, ICICI and they compete against the state owned banks in India; they embrace technology and the marketplace embraces them. And their share price is up a couple 100% in the last two years on the back of the kind of themes that I'm identifying. But I think that theme can play itself out in a lot of the emerging markets. And so we're spending a lot of time saying who we might see that fits that bill.

Ken:

So as we look through the second-half of the year, what are some final thoughts you want to leave us with about emerging markets?

Paul:

Well, I don't know that I'd want to truncate it to just like the last six months but, I would say the following; sometimes people think about emerging markets is a place to invest in for tomorrow and I think that's not true, I think it's a place to invest in today.

And so as I look at the valuation levels that exist, as I look at new supply chains that are being formed, as I look at the education and the innovation that's occurring, I think if you have the right horizon, it's a good time to, you know, put your foot in the water, toe in the water, body in the water, and to be a participant of the opportunities that I think are going to avail themselves over the next several years.

So I would just say, I mean there's always going to be in every market things and considerations in the moment. But in the sands of time so far as I know we haven't repealed physics, and gravity will still prevail and the gravity of some of these pools that I've identified is in the direction of a lot of the companies in emerging markets.

Ken:

Paul, that was a great final take away. I love your long term view. I want to thank you for joining us today and I want to especially thank you for the great performance that you've delivered for all of our shareholders. So thanks again.

Paul:

I appreciate working for all of them and I appreciate your all sponsorship.

Ken:

Thank you.

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