



Invested in Emerging Markets:

Key Themes Across Latin America and China

October 2023



Emerging Markets Value

Marc P. Miller
Partner | Portfolio Manager

Matej Susec
Research Analyst

Introduction

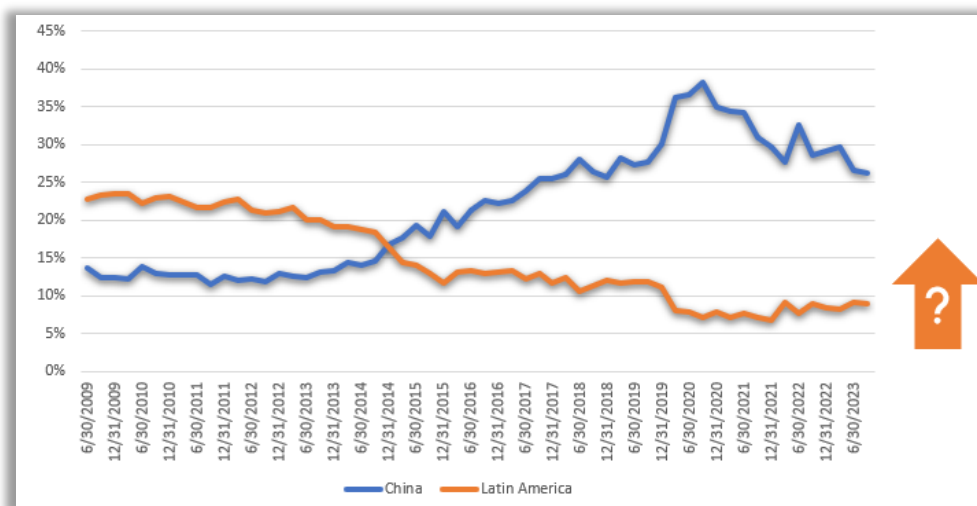
Emerging Markets offer a diverse set of investment themes to investors wanting to participate in the socio-economic transformations of these countries. Valuations in Emerging Markets have reached the lowest point in 36 years relative to the US equities¹ despite better economic growth prospects and more downside inflation surprises.

At DRZ Investment Advisors, we have implemented a time-tested Value investment methodology for over 25 years. Our Emerging Markets Value Strategy was established in 2010 and has excelled through various market conditions, outperforming the MSCI Emerging Markets Index YTD through September 30th, as well as for the 3, 5, 7, and 10-year timeframes. Emerging Markets offer compelling Value investment opportunities as we find ourselves in the latter stage of the market cycle amid a higher interest rates environment.

Emerging Markets have been impacted this year by weaker-than-expected China. While China was affected by the reversal of globalization and a weaker property sector which are largely priced in the market valuations, we believe that market sentiment is close to peak pessimism at this point. More recently, the Chinese authorities have been addressing some of the causes through incremental easing and stimulus measures. In addition, China remains one of the largest economies globally and is expected to contribute 34.9% of global economic growth in 2023 according to the IMF². We are starting to see some signs of a recovery based on manufacturing demand and improved consumer spending, reflected during the Golden Week. In addition, we also highlight opportunities in another region of Emerging Markets - Latin America.

Interestingly, in 2009, Latin America represented 24% of the MSCI Emerging Markets Index, compared to China at 12%. Fast forward to today, Latin America only represents 9% of the Emerging Markets Index. We believe the nearshoring trend, favorable policy backdrop, and rich reserves of green metals needed in the renewable energy transition should improve the prospects of equities in Latin America.

Exhibit 1: Latin America's and China's MSCI EM Index Weight



Source: Bloomberg Terminal

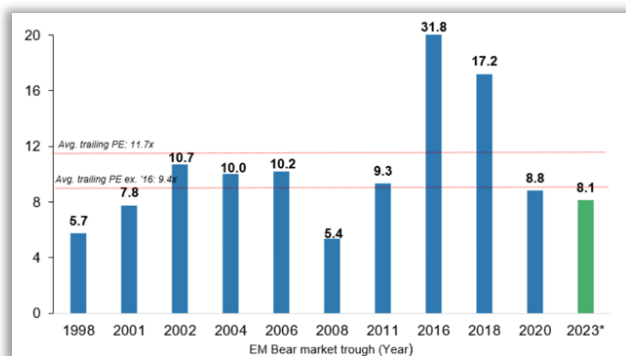
Latin America: Several Investment Themes to Drive Performance

We continue to favor Latin America over the other regions in the Emerging Markets. Mexico has been the primary beneficiary of nearshoring, and we believe it will remain an important driver of economic growth in the coming years. Brazil has been neglected by the international investor base which we find unwarranted as most of the worries around US rates and fiscal adjustments in Brazil appear to be priced into the market valuation. In addition, its Central Bank's successful interest rate hiking cycle has tamed inflation which allowed the start of the easing cycle, likely providing further tailwinds for equities. Finally, we also see opportunities across Latin America due to its ample green metal reserves, which will serve as key inputs to achieving global decarbonization goals.

Valuations

Latin America as a region has attractive valuations for Value investors. The current MSCI Latin America Index valuation is below the average observed in most prior trough valuations and earnings cycles. Troughs with lower valuations were only observed after the Asian Financial Crisis in 1998, the Dot-com bubble in 2001, and the 2008 Global Financial Crisis.

Exhibit 2: MSCI EM Index Trailing P/E's



Source: Morgan Stanley Research on 7/28/2023

All five countries in the MSCI Latin America Index are below their respective 10-year average trailing P/E valuations. On a relative basis to the broader MSCI Emerging Markets Index, all five countries appear even more inexpensive, trading at one standard deviation or more below the 10-year average trailing P/E multiple³.

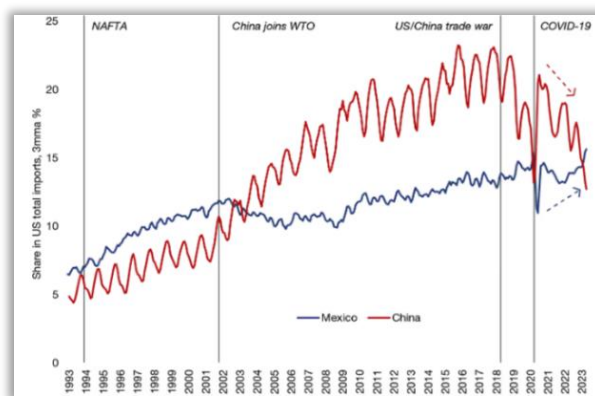
Nearshoring

Nearshoring is a trend of a company moving parts or all of its production to a destination closer to the final

consumer. Nearshoring has been propelled by multiple factors including companies' diversifying supply chains, heightened geopolitical tensions, inflationary pressures, and new regulations.

Mexico has seen the largest benefit from nearshoring as it has in the first half of 2023 overtaken China's leading share of U.S. imports as seen in Exhibit 3. Despite the easing of pandemic logistics bottlenecks, transit days from Asia to the US doubled and freight rates are over 5 times as high as pre-pandemic⁴.

Exhibit 3: Share of U.S. Total Imports (Mexico vs. China)



Sources: Bank of America, Haver, U.S. Census Bureau

Mexico's trade-to-GDP ratio is 89%, which is above the global average⁵. The US and Canada are Mexico's main trading partners and equate to over two-thirds of Mexico's total trade. The United States-Mexico-Canada Agreement (USMCA), effective since July 2020 is incentivizing nearshoring. USMCA replaced the North American Free Trade Agreement (NAFTA). The new agreement expands the rules of origin and rules of evidence for maintaining zero tariffs which benefits local producers the most.

Another benefit for Mexico is the US Inflation Reduction Act (IRA), signed in 2022. It offers tax credits not only for electric vehicles (EVs) manufactured in the US but also for those in Mexico. Mexico is the seventh-largest global manufacturer of passenger vehicles of which 90% are exported⁶. Currently, automotive exports as a % of GDP have more than doubled since 2009 and represent over 11% of Mexico's GDP⁷. This trend is likely to continue. Propelled by USMCA and IRA, Tesla

Invested in Emerging Markets

and its suppliers are expected to invest \$15 billion into a gigafactory near Monterrey, Mexico⁸.

The manufacturing industries in Mexico have shifted towards more complex products beyond the automotive industry. Mexico is a leading supplier of medical devices and among the top ten largest exporters in the IT and aerospace industry to the US.

The increase in manufacturing demand is also reflected in the industrial space availability. In the main Mexican markets, the industrial vacancy rate is below 2% which is well below the 10% rate in 2011⁹. With the growing demand, rents across main cities have also increased.

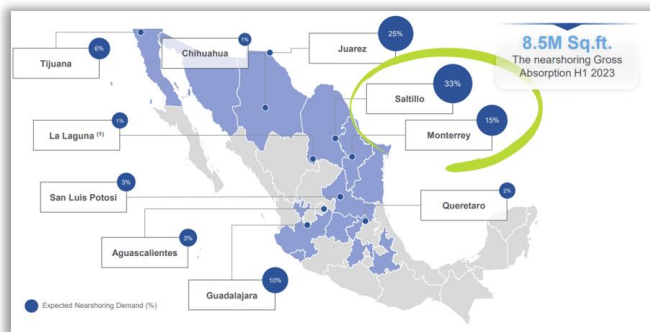
Exhibit 4: Industrial Parks in Mexico's Major Cities



Sources: Franklin Templeton, SHCP, Newmark

Geographically, mainly northern and central regions of Mexico are benefiting from increased industrial activity due to proximity to the US border. As seen in Exhibit 5, the expected increase in industrial market demand is between 15% and 33% in cities such as Monterrey, Saltillo, and Juarez.

Exhibit 5: Industrial Market Nearshoring Demand Growth



Source: CBRE

As the demand for industrial space increases, so do the expectations of production automation and environmental considerations. An E&Y research study

shows that by 2035, 45% of supply chains are expected to be autonomous¹⁰. On the clean energy side, more LEED green buildings will be required as demanded by some large institutional investors. Mexico currently ranks seventh in the world for LEED green buildings certified total space, which grew by 79% YoY in 2022¹¹.

Another favorable factor for Mexico is its labor costs, which are cheaper relative to China. Interestingly, China's manufacturing labor costs per hour exceeded Mexico's since 2011¹². In China, the average manufacturing salary is \$13k/year compared to \$3k/year in Mexico¹³. Mexico also has an increasingly skilled and relatively young workforce with 42% of people between the ages of 20 and 49.

DRZ Emerging Markets Value Fund Portfolio Manager, Marc Miller recently visited Mexico to meet with the top management and investor relations teams of multiple companies. His interactions and observations confirmed the positive implications of nearshoring on many Mexican companies.



Marc Miller (middle) visiting facilities of Ternium, the largest flat steel producer in Latin America.

Policy Backdrop within Latin America

In the current environment of higher interest rates, most of Latin America is better positioned than in the recent past. As an illustration, Latin America's external debt-to-GDP rose from 22.6% in 1975 to 42.9% in 1982. The 1970s were a period of low interest rates and excess liquidity that incentivized borrowing, similar to the characteristics of the 2010s. With interest rate hikes driven by the US Federal Reserve to the peak of 18.6% in 1981, a debt crisis followed.

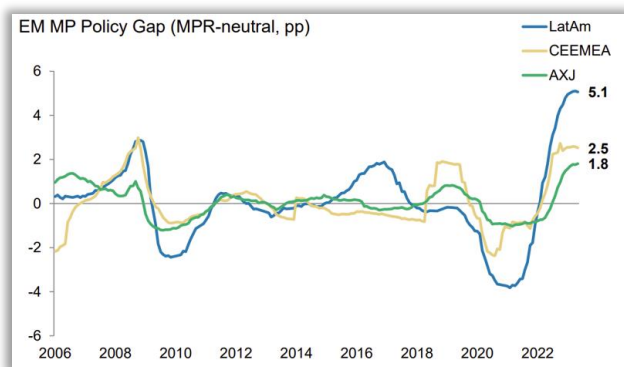
Fast forward 40 years, Latin America's debt to GDP has risen to 69% in 2021, however, the region has better

Invested in Emerging Markets

prospects to deal with the debt increase. After the 1980s, a number of new policy frameworks were implemented. For example, central banks modernized by reducing financing to governments, trade and capital flows were liberalized, and inflation target policies were adopted. This time around, many Latin American countries raised interest rates ahead of Developed and other Emerging Markets to ease inflation and limit currencies from devaluation. Moreover, the Federal Reserve's interest rates are at 5.50% which is not as high as in the early 1980s.

The current rate hike cycle is further along in Latin America than in EMEA and Asia as seen in Exhibit 6. Brazil, for example, was one of the first countries in the region to hike interest rates, which supported the deceleration of inflation from the peak of 12.1% in April 2022 to 4.0% in July 2023. In 2023, Brazil, Chile, and Peru were some of the first countries in the region to cut interest rates and should benefit with more room to lower rates.

Exhibit 6: Rate Hike Cycle for EM Regions



Sources: Bloomberg, Morgan Stanley Research

In addition, in 2021 and 2022 the majority of Latin America withdrew fiscal stimulus as the debt-to-GDP ratio improved compared to pre-pandemic levels and was 4 percentage points lower than large Emerging Markets countries¹⁴.

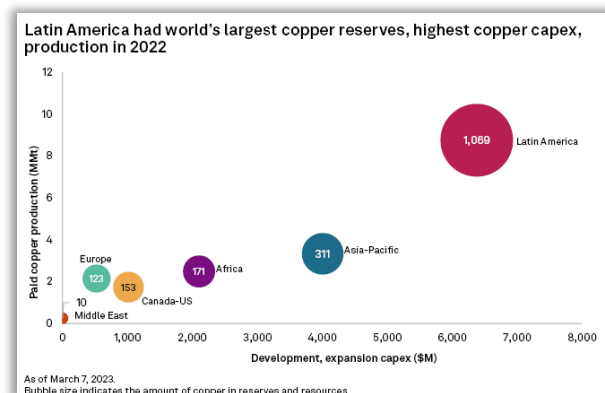
Ample Reserves of Green Metals

The green energy transition shift from fossil-based systems to renewable energy sources presents an interesting opportunity for Latin America, a mineral-rich region. According to the IEA, to achieve the Net Zero Emission scenario by 2050, the green transformation has to happen three times faster than the adoption of

coal and oil. The main “green metals” include copper, lithium, nickel, cobalt, and steel.

The net demand for copper driven by EVs is projected to more than double by 2030¹⁵. Copper is not only used in EVs but also in construction, power generation, and consumer electronics. On the supply side, Latin America has the highest reserves, capital expenditures, and production of copper in the world. Notably, Chile and Peru are the highest copper-producing countries, mining 37% of global copper.

Exhibit 7: Copper Around the World



Source: S&P Global Market Intelligence

Currently, there are certain supply constraints affecting copper availability. The entire process from copper mine discovery to production takes 15.7 years on average¹⁶. Mining projects are subjected to different federal and provincial requirements. The production ramp-up rate has slowed and there has been a lack of new large discoveries while copper ore grades are declining. Recently, Chile had a 7% year-over-year decline in copper output in 2022, and Peru had a decline of 5.8% in 2023¹⁷.

Copper supply is also affected by water scarcity and political unrest in certain countries. While some of the supply restraints can be offset with recycling, S&P Global estimates that the global copper market could see a deficit of up to 9.9 million tons by 2035¹⁸.

Our largest OW within the Emerging Markets Value Fund is Latin America as of September 30, 2023, for the reasons mentioned above.

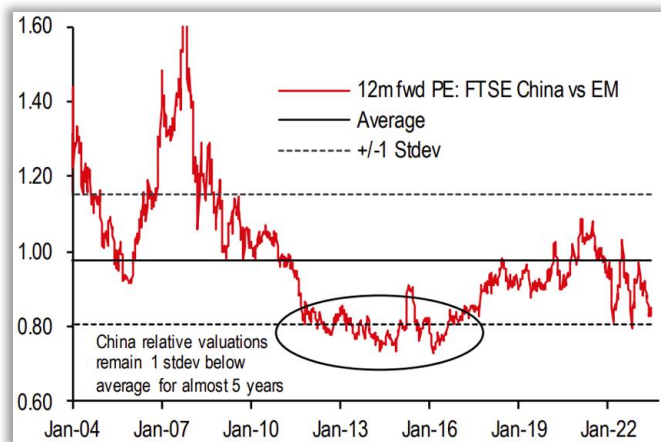
China: What has Changed and Where are Opportunities?

We believe the current market sentiment is close to peak pessimism which is reflected in valuations in China. So far, the authorities have been focused on incremental easing versus providing a massive stimulus. According to the IMF, China's share of total global exports may have peaked in February 2021 at 15.7%, however, its trade surplus has continued to grow¹⁹. We believe that Chinese equities appear to be bottoming as manufacturing demand, property sales in September, and the Golden Week sales have shown some signs of economic recovery.

Valuations

Chinese equities have attractive valuations relative to their historic values when compared to Emerging Markets. The 12-month forward P/E multiple to Emerging Markets multiple ratio is close to a one standard deviation event below the historic average as seen in Exhibit 8.

Exhibit 8: Forward P/E Valuation



Sources: FTSE Russell, FactSet, HSBC

After a time of accelerated inflation, regulatory changes, and rising public debt, there was a period in the early-to-mid 2010s when the relative valuations remained at this level for an extended amount of time.

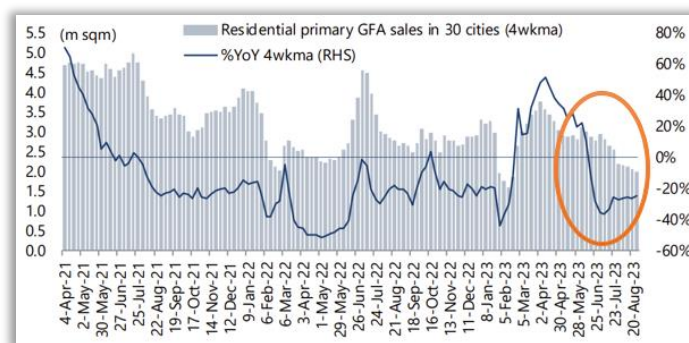
Property Sector

Perhaps the biggest change that China has experienced recently, is a weakening property sector. This sector has been a significant economic growth

driver over the past three decades and currently accounts for approximately 30% of GDP²⁰. However, it experienced a decline post the COVID-19 pandemic.

The struggles can be attributed to the state-led initiatives encouraging urbanization with local governments heavily reliant on land sales to property developers. This involved property developers providing cash loans to potential homebuyers, granting them the opportunity to acquire homes without an upfront payment. COVID-19 lockdowns halted land purchases and construction activity. As a result, new home sales have declined resulting in liquidity concerns among property developers. In the second quarter of 2023, post-reopening, the residential space started to improve. However, sales decreased significantly after the pent-up post-reopening demand for house upgrades subsided as seen in Exhibit 9. This additionally dented consumer confidence.

Exhibit 9: China Residential Primary Market Floor Space Sales in 30 Major Cities



Sources: WIND, Jefferies

In China, approximately 70% of household wealth is tied to real estate²¹. With declining property values, many people have experienced a loss in household savings. This is one of the drivers of low consumer confidence, which is also affected by a higher youth unemployment rate which was 21.3% in June of 2023 before the Chinese government stopped reporting on this indicator²².

As a response to the current landscape, the Chinese government has implemented a variety of smaller-

scale stimulus measures to facilitate the stabilization of the housing market. Some of the initiatives include interest rate cuts, modifying down payment requirements, and offering the opportunity to buy more than one property per family. The nation's average mortgage rate is 4.11%, which is 0.51% lower YoY²³, encouraging buying. While still early to ascertain as seasonality is a factor, property sales improved with a MoM increase of 18% in September²⁴.

Geopolitics

Geopolitical tensions have impacted China's economy. In 2018, the US and China both imposed trade tariffs on each other. From July to September of 2018, the US average tariffs increased from 3.8% to 12.0%, while China's average tariffs rose from 7.2% to 18.3%²⁵. In 2019, an additional set of tariffs kicked in and became the new normal for the countries.

There have been other tensions between China and the US. For example, the US imposed restrictions on Huawei in 2019, as a result of the US ban on use of foreign telecommunications equipment deemed as a national security threat. In 2022, the US issued new rules to limit the sales of high-end computer chips to China. In addition, the FDI inflows in China have been decreasing since 2020, coinciding with China's decrease in MSCI Emerging Markets Index weight from the all-time high.

Demographics

China's population is aging with fewer working-age people, mainly driven by the one-child policy from 1980 to 2016. The consequences are starting to show as in 2022, China's population declined for the first time in sixty years. To limit the aging of the population, the Chinese government and some cities started offering housing subsidies for families, longer maternity leave, and allowances to mothers with more than one child on some occasions. In addition, Chinese labor productivity has seen a large increase, with GDP per worker growth outpacing the GDP growth of 6.2% between 2012 and 2022²⁶.

Debt Levels and Economic Outlook

China's debt-to-GDP ratio rose to a record high in 2023. Among Emerging Markets countries, China had the highest increase in debt post the 2008 crisis²⁷. Part of the explanation lies in China bailing out indebted countries, lending \$240 billion in total bailout loans

from 2008 to 2021²⁸. This leads to heightened hesitancy towards borrowing for expansions.

More recent reports, however, suggest improvement in the economic outlook. As of September 2023, the Chinese economy is showing some signs of expansion. The manufacturing sector indicated growth for the first time since March with a PMI over 50. Overseas demand has started to recover due to an improvement in manufacturing. In addition, consumer spending and other services spurred the expansion of non-manufacturing sectors in September.

Opportunities

China remains the second-largest world economy with the second-highest population. While its real GDP growth is not expected to reach high single digits experienced before the COVID-19 pandemic, it is expected to grow at a 4.5% rate annually in 2024 and 2025²⁹. This is still higher than many other economies among Emerging Markets as well as the US. Additionally, while some industries such as real estate and property development are being pressured, the companies that will weather the storm will benefit from market share gains. As consumer spending has shown signs of slight improvement, there will likely be opportunities when consumer sentiment improves even further. We remain nimble for opportunities in China and continue to prudently monitor the market.

Ultimately, we are excited about the prospects that investments in Emerging Markets offer. We believe that our seasoned team and disciplined investment process is well positioned to capture the multitude of opportunities in Emerging Markets.

References

- ¹ Bloomberg Terminal on 10/10/2023. "Emerging-Market Stocks Sink to Lowest Since 1987 Versus S&P 500".
- ² IMF. "Asia Poised to Drive Global Economic Growth, Boosted by China's Reopening".
- ³ Bloomberg Terminal as of 10/18/2023.
- ⁴ Vesta SAB as of May 2022.
- ⁵ The World Bank Group. worldbank.org.
- ⁶ International Trade Administration. "Mexico - Automotive Industry".
- ⁷ INEGI, Morgan Stanley Latam Economics.
- ⁸ Reuters. "Tesla, suppliers to invest \$15 billion in Mexico factory, local governor says".
- ⁹ Prologis Research, Solili, CBRE.
- ¹⁰ E&Y. "How COVID-19 impacted supply chains and what comes next".
- ¹¹ Green Business Certification Inc., "Mexico Ranks Number Seventh in the World for LEED Green Building in 2022".
- ¹² BTG Pactual.
- ¹³ AMVO and Euromonitor.
- ¹⁴ IMF. "Investments That Pay Off: Latin America's Response to Recent Global Shocks".
- ¹⁵ Reuters. "Innovation in EVs seen denting copper demand growth potential".
- ¹⁶ S&P Global. "Discovery to production averages 15.7 years for 127 mines".
- ¹⁷ U.S. Department of Energy. "Critical Materials Assessment".
- ¹⁸ S&P Global. World copper deficit could hit record; demand seen doubling by 2035: S&P Global.
- ¹⁹ International Monetary Fund.
- ²⁰ Yahoo Finance. Chinese real estate may be the world economy's 'most important single sector,' says Fitch. But don't expect Beijing to save it from crisis.
- ²¹ Bloomberg Reuters, ECB, Fed, HSBC.
- ²² Wind, Daiwa.
- ²³ Bloomberg. "China Banks to Cut Mortgage, Deposit Rates in Stimulus Bid".
- ²⁴ Wall Street Journal, "China's Economy Picks Up Amid Risk".
- ²⁵ Peterson Institute for International Economics. "US-China Trade War Tariffs: An Up-to-Date Chart".
- ²⁶ Citigroup.
- ²⁷ Refinitiv Datastream, IIF, HSBC.
- ²⁸ Reuters. "China spent \$240 billion bailing out 'Belt and Road' countries - study".
- ²⁹ Bloomberg Terminal consensus as of 9/20/2023.

Disclosures

DePrince, Race & Zollo, Inc.
EMERGING MARKETS VALUE COMPOSITE
June 30, 2010 through September 30, 2023.

Year	Gross Return(%)	Net Return(%)	Index Return(%)	Composite 3-Year Annualized Standard Deviation	Index 3-Year Annualized Standard Deviation	Number of Portfolios	Composite Dispersion(%)	Strategy Assets (\$Millions)	Total Composite Assets(\$Millions)	Total Firm Assets (\$Billions)
12/31/22-09/30/23	2.55	1.97	1.84	18.40%	17.65%	≤5	N/A	382	382	4.515
2022	(15.60)	(16.28)	(20.09)	22.49%	20.26%	≤5	N/A	327	327	4.756
2021	3.39	2.56	(2.54)	21.40%	18.34%	≤5	N/A	400	400	4.347
2020	16.70	15.77	18.31	22.54%	19.60%	≤5	N/A	289	289	3.447
2019	22.07	21.11	18.43	13.54%	14.17%	≤5	N/A	245	245	3.562
2018	(14.37)	(15.06)	(14.58)	14.33%	14.60%	≤5	N/A	462	432	3.916
2017	32.20	31.17	37.28	15.97%	15.35%	≤5	N/A	142	142	4.814
2016	16.67	15.75	11.19	17.06%	16.07%	≤5	N/A	92	92	5.565
2015	(12.73)	(13.44)	(14.92)	14.96%	14.06%	≤5	N/A	79	40	5.788
2014	(5.44)	(6.20)	(2.19)	15.01%	15.00%	≤5	N/A	89	46	7.901
2013	5.09	4.26	(2.60)	18.45%	19.04%	≤5	N/A	32	32	8.517
2012	17.96	17.03	18.22	N/A	N/A	≤5	N/A	16	16	6.770
2011	(21.77)	(22.40)	(18.42)	N/A	N/A	≤5	N/A	13	13	6.588
06/30/10										
12/31/10	29.85	29.35	26.69	N/A	N/A	≤5	N/A	17	17	5.832

Performance: 1, 5, 10 year as of 12/31/2022

	1 year	5 year	10 year
DRZ Emerging Markets (Gross Fees)	(15.69)	1.24	3.59
DRZ Emerging Markets (Net Fees)	(16.37)	0.43	2.76
MSCI Emerging Markets Index	(20.09)	(1.40)	1.44

DePrince, Race & Zollo, Inc. has presented this report in compliance with the Global Investment Performance Standards (GIPS®).

- DePrince, Race & Zollo Inc. (DRZ) is an independent investment management firm, founded in 1995, that manages equity portfolios primarily for U.S. institutional clients.
- DRZ claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. DRZ has been independently verified for the periods March 31, 1995 through December 31, 2022 by The Spaulding Group. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS Standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. The verification reports are available upon request.
- GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.
- Accounts that experience cash flows of 10% or more will be temporarily removed from the composite for one month; this policy applies to all periods. Additional information regarding the firm's policies for valuing portfolios, calculating performance, and preparing GIPS reports are available upon request.
- The composite invests in global stocks through ADRs and securities in emerging market countries that have an expected positive dividend yield and a market capitalization typically above \$200 million. Holdings that do not achieve the expected dividend yield may be considered for sale.
- Past performance is not indicative of future results. The actual return and value of an account will fluctuate and at any point could be worth more or less than the amount invested. Individual account performance will vary according to individual client investment objectives.
- The benchmark is the MSCI Emerging Markets Index ("Index") which is a free float-adjusted market capitalization index of companies in emerging markets. The Index captures approximately 2,600 mid and large cap securities across more than two dozen emerging market countries. DRZ's Emerging Markets portfolios generally consists of 50-80 securities and do not have exposure to all countries included in the Index. While the Index is believed to be the most relevant benchmark, material differences exist between the Index and DRZ's managed portfolios. Discussion of securities' price fluctuations during the period is provided for informational purposes only. The holdings discussed were positions that had the most impact to the portfolio's overall return for the period. The portfolio's Net of Fees provides the cumulative performance of all positions held. Period performance of each security held in the portfolio is available upon request.
- Total time-weighted rates of return are expressed in US dollars. Computations include the reinvestment of all dividends and capital gains. For investments in ADRs and foreign domiciled companies, dividends are included net of any withholding taxes.
- The composite creation date is July 1, 2010, and the composite inception date is June 30, 2010. DRZ's list of composite descriptions is available upon request.
- The gross-of-fees returns are net of transaction costs.
- Net-of-fees returns are calculated by deducting a model management fee of 0.067% using the highest management fee of 0.80% from the monthly gross-of-fee composite return. Starting in 2020 the fee schedule was revised retroactively from 90 to 80bps.
- DRZ's standard fee schedule for Emerging Markets Value is 0.80% on all amounts.
- Internal dispersion is calculated using the equal-weighted standard deviation of annual gross-of-fee returns of those portfolios that were included in the composite for the entire year; it is not presented for periods with 5 or fewer portfolios. The three-year annualized ex-post standard deviation measures the variability of the composite gross-of-fee returns and the benchmark returns over the preceding 36 months period. The composite doesn't have the three-year annualized standard deviation for 2011 and 2012 because 36 monthly returns are not available. The three-year ex-post standard deviation is not required for periods prior to 2011.
- All information including portfolio and performance statistics contained in this document is presented at the composite level rather than for an individual account. This presentation is for informational purposes only and should not be deemed as a recommendation to buy the securities mentioned. The securities highlighted in this document, if any, represent recent holdings. Each quarter, DRZ uses the same objective, non-performance based criteria to select these securities. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities discussed in this report.
- If clients are listed in this document, it is not known whether they approve or disapprove of DRZ or the advisory services it provides. If included, the representative clients listed in this document are a cross section of current accounts that maintain similar investment objectives as those expressed by DRZ's prospective clients. This list may include accounts that are not invested in the investment strategy described in this document.