

Aberdeen Emerging Markets

10.6% a year for 20 years

Aberdeen Emerging Markets (AEMC) will be 20 years old on 22 June 2018. This is no small feat; it has survived numerous crises in emerging markets (EM), the distortions of 'hot money' and a long-standing market focus on growth sectors (which does not suit the managers' value-investment style). Furthermore, since launch, it has delivered an NAV return of 646% or 10.6% a year, ahead of the MSCI Emerging Markets Index, 541% or 9.8% per annum, and well ahead of the MSCI World Index, 256% or 6.6% per annum*.

* All figures to end May 2018

Consistent outperformance of MSCI Emerging Markets Index

AEMC invests in a carefully selected portfolio of both closed-and-open-ended funds, providing a diversified exposure to emerging economies. It aims to achieve consistent returns for its shareholders in excess of the MSCI Emerging Markets Net Total Return Index in sterling terms.

Year ended	Share price total return (%)	NAV total return (%)	MSCI Emerging Markets TR. (%)	MSCI World total return (%)
31/05/14	(8.0)	(9.1)	(5.8)	7.4
31/05/15	9.6	9.4	9.9	16.2
31/05/16	(14.5)	(9.9)	(13.6)	0.7
31/05/17	42.6	40.7	43.6	31.3
31/05/18	9.5	8.1	10.6	8.2

Source: Morningstar, Marten & Co

Sector	Global emerging
Ticker	AEMC LN
Base currency	GBP
Price	608.0p
NAV	705.35
Premium/(discount)	(13.8%)
Yield *	3.45%

* based on forecast 21p dividend

Share price and discount

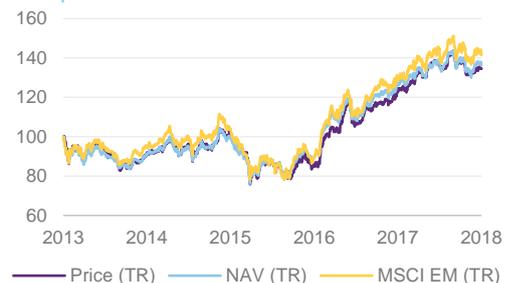
Time period 31/05/2013 to 31/05/2018



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/05/2013 to 31/05/2018



Source: Morningstar, Marten & Co

Domicile	Guernsey
Inception date	22 June 1998
Manager	Andrew Lister and Bernard Moody
Market cap	280.0m
Shares outstanding	46.0m
Daily vol. (1-yr. avg.)	57,289 shares
Net gearing	6.1%

[Click here for our initiation note](#)

Still standing, still relevant

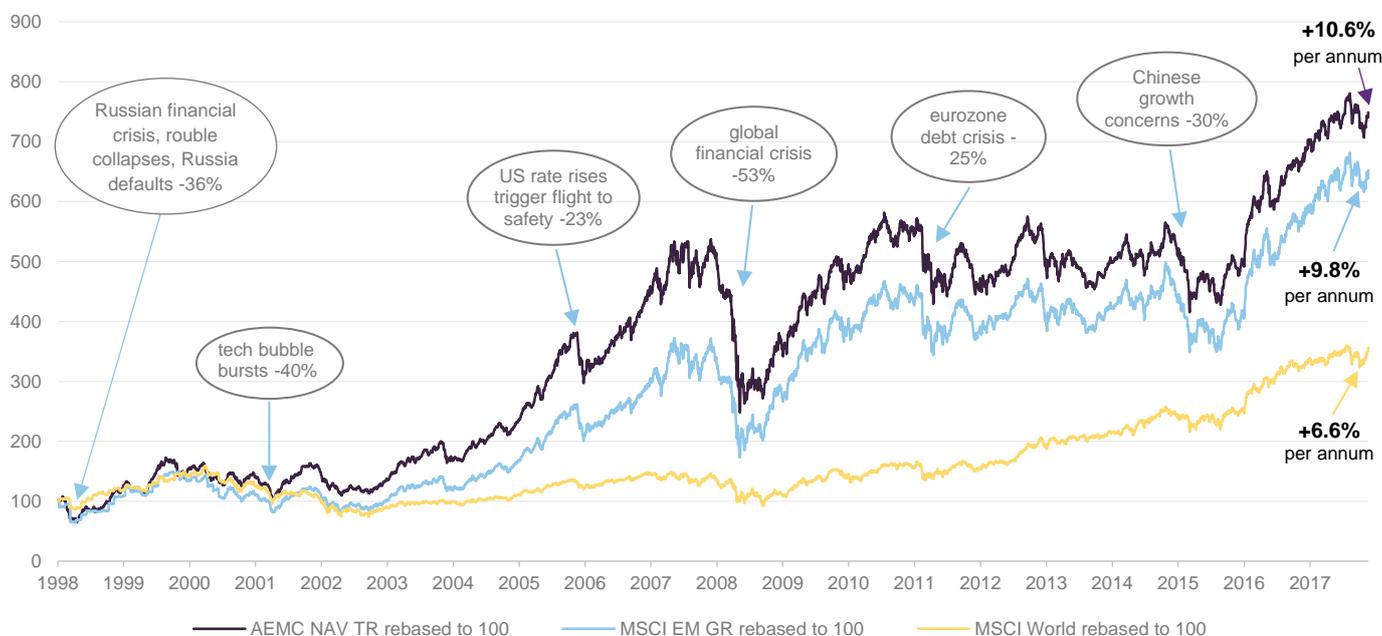
AEMC has evolved over the past 20 years with initiatives such as the introduction of a dividend

It is almost 20 years since AEMC was launched. The world has changed much since 1998 and AEMC has evolved with it. Our initiation note, published in September 2017, described the many initiatives that AEMC has instigated in recent years to maintain its position, including a reduction in fees, the introduction of the dividend, putting a borrowing facility in place and the team's move to Aberdeen Standard Investments.

The two lead managers, Andrew Lister and Bernard Moody, have been involved with the management of the trust since October 2000 and August 2006, respectively.

Surviving the crises

Figure 1: 20-year history of AEMC and the MSCI Emerging Markets Index (EM index crisis moves peak to trough)



Source: Morningstar, Marten & Co, figures to 31 May 2018

Crises present opportunities

The nature of EM investing is that there always seems to be a crisis somewhere. For example, very soon after the launch of the fund, emerging markets were sideswiped by the Russian financial crisis, which saw emerging markets fall c30% in the first three months of the fund's life. The chart in Figure 1 suggests that the long-term effect on AEMC was minimal. For a long-term investor such as AEMC, these crises present great opportunities to make investments at attractive valuations, sowing the seed of decent performance in years to come.

You can access the fund's website at <http://www.aberdeenemergingmarkets.co.uk>

AEMC was almost entirely invested in closed-ended funds in its early years. Many of these have been lost to liquidations, mergers and takeovers. AEMC was able to profit as discounts were eliminated on these funds but, over time, turned to the open-ended market. This allowed it to gain access to the best managers and strategies and to optimise its asset allocation.

An update on the managers' views on emerging markets

Recovery following the China 'growth scare' encouraged inflows to EM equities

Emerging markets have been recovering for a couple of years now, as 2015's 'nerves' about Chinese growth rates have eased. Sentiment towards the sector has improved and there have been substantial inflows into EM equities. The question is: how long can this go on for? Analysts are predicting 25% earnings growth for this year, which the managers feel might be overambitious. It is true that corporate margins are recovering and the managers are encouraged that this is not being driven by rising debt levels. Free-cash-flow yields are rising and this is flowing through into dividends. Income-focused strategies have struggled however.

The widespread exuberance might raise worries about the longevity of this recovery but the managers point out that this upward move is still quite shallow when compared to previous upswings. In the managers' opinion, valuations are not excessively high and the recovery has been supported by earnings growth. This has been aided by currency stabilisation, underpinned by strong current accounts (the Indian rupee and the Chinese renminbi were both strong).

AEMC manager's style biased to value

In recent years, investors have been favouring growth stocks, especially those in the technology sector. The managers believe that many strong companies in other sectors have been left behind in this rally. This does not suit AEMC's managers' style, which seeks to access emerging market growth at a reasonable valuation.

The managers think that AEMC has done well to keep up with the index in this environment, especially given its structural underweight exposure to the largest companies in the benchmark, especially the Chinese technology giants which are becoming a large part of the MSCI China Index (Tencent and Alibaba were 29.7% of the index at the end of April 2018). In this market, as in many others, many of the underlying managers are running funds that conform with UCITs rules. These constrain those managers' exposure to the largest stocks.

China's economy remains the overarching risk for the sector. The country is increasingly dominant in terms of its weighting within equity indices, as its domestic, A-share stocks are gradually incorporated within the MSCI index 'family'.

We have seen a mid-cycle correction in markets

Investors do appear to be increasingly nervous. Talk, once again, is of a 'Fragile Five', a term that was originally coined in 2013 to describe Turkey, Brazil, India, South Africa and Indonesia, when those economies were seen as challenged. Today, Argentina may have replaced India. Other concerns include US inflation, dollar strength and the direction of US interest rates. The managers believe that this has led to a mid-cycle correction in markets, rather than the end of this bull market.

Maintaining underweight exposure to India

AEMC has an underweight exposure to the Indian market relative to the MSCI Emerging Markets Index. The managers say that they cannot reconcile valuations of Indian equities to fundamentals and believe that the market is vulnerable in the event of any negative news. Domestic investors are piling into the market and driving up valuations. They say that the underlying managers are struggling to find value at these levels. AEMC's managers think that some caution is now needed and that there may be a better opportunity further ahead.

The Russian market fell quite sharply in the wake of new sanctions. The managers felt that valuations were already attractive and took the opportunity to add to positions (see page 5). A higher oil price is beneficial to Russia's economy and this is helping the rouble. Russian stocks have rebounded from their lows.

Asset allocation

Figure 2: AEMC asset allocation by country

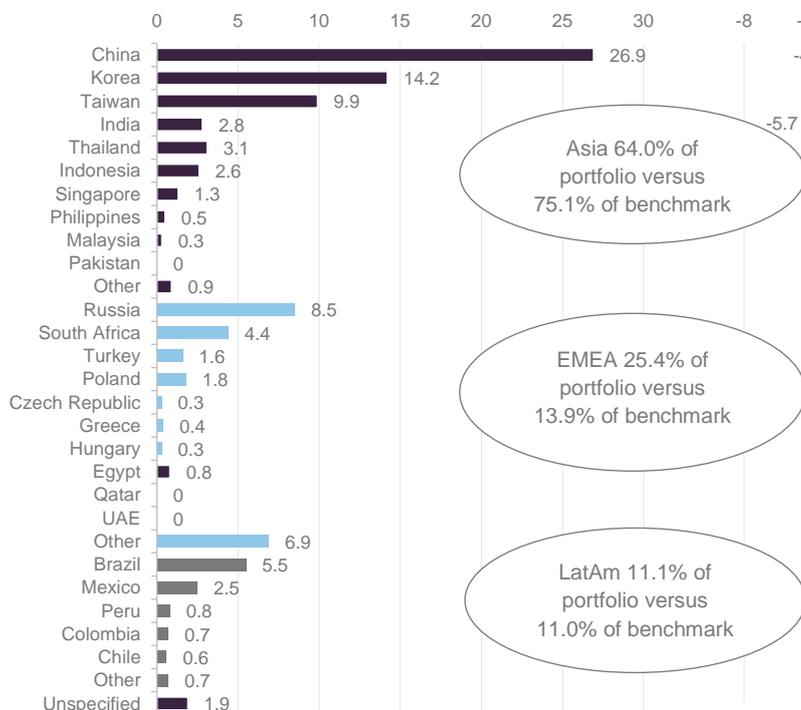
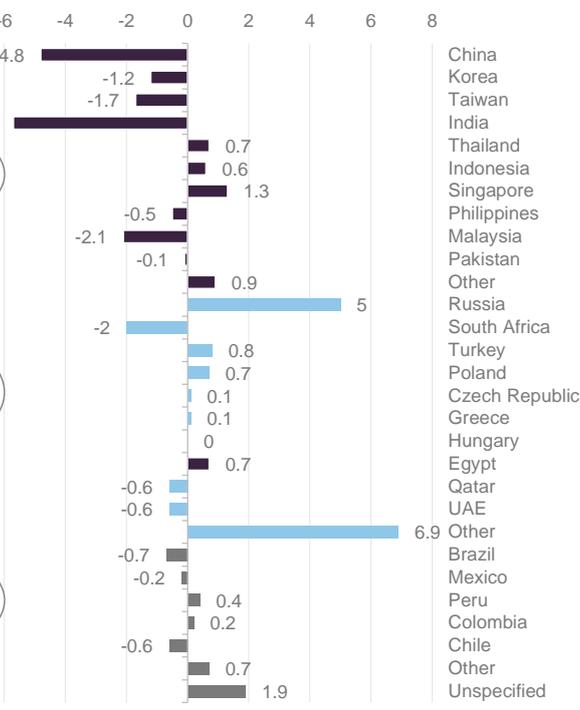


Figure 3: AEMC asset allocation versus benchmark



Source: Aberdeen Emerging Markets, Marten & Co

Source: Aberdeen Emerging Markets, Marten & Co

For the reasons outlined above, relative to the benchmark, AEMC has maintained its underweight exposure to China and India. The largest overweight exposure is to Russia, which offers inexpensive valuations, benefits from strong terms-of-trade as energy prices have recovered, is seeing positive corporate earnings revisions, runs a current account surplus and has an undervalued currency.

Largest holdings

Figure 4: 10 largest holdings as at 31 May 2018

Stock	% of total assets 31/05/18	% of total assets 31/10/17	% Change	Open or closed?	Discount as at 31/05/18	Country or region
NB China Equity	9.9	8.8	+1.1	Open	n/a	China
Schroder Asia Pacific	7.3	6.3	+1.0	Closed	11.0	Asia Pacific
Schroder Taiwan Equity	7.0	7.0	0.0	Open	n/a	Taiwan
Weiss Korea Opportunity	6.9	6.2	+0.7	Closed	3.0	Korea
Fidelity China Special Situations	6.7	5.5	+1.2	Closed	13.4	China
BlackRock Emerging Europe	6.0	5.0	+1.0	Closed	5.4	Europe
Brown Advisory Latin America	5.8	5.9	-0.1	Open	n/a	Latin America
Avaron Emerging Europe	4.8	3.2	+1.6	Open	n/a	Europe
SCM South Africa	3.8	3.5	+0.3	Open	n/a	South Africa
Laurium Limpopo	3.6	2.8	+0.8	Open	n/a	Africa
Total of top 10	61.8					

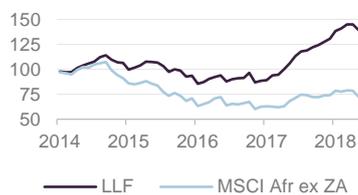
Source: Aberdeen Emerging Markets, Marten & Co

Figure 4 shows how the line-up of the top 10 holdings has changed since AEMC's year end on 31 October 2017. One thing that is obvious is the increased concentration of the portfolio. Back in October, the top 10 holdings accounted for 57.3% of the fund. At the end of May 2018, they made up 61.8% of the fund.

We discussed many of these funds in our last note. In March, it emerged that the team at Findlay Park, managers of what was the Findlay Park Latin American Fund, would be moving to Brown Advisory. The fund changed its name with effect from 30 April 2018. The two lead managers, who have 28 years' experience of investing in Latin America, remain in place and their investment approach is unchanged. Findlay Park's business is now focused on its developed market American product.

Laurium Limpopo

Figure 5: Laurium Limpopo vs. MSCI Africa ex South Africa



Source: Laurium Limpopo, Marten & Co

Africa is seen as a late-cycle play by many EM investors. The managers noted that African equities were out of favour but commodity prices, which have a significant effect on many African economies, were recovering. In addition, some countries such as Egypt had 'bitten the bullet' and devalued their currencies. In this region the closed-ended options are very limited. The managers made an investment in the South Africa-based Laurium Limpopo Africa Fund. This \$190m open-ended fund offers monthly dealing to accommodate the volatility and general lack of liquidity in the underlying markets. It has built up a reasonable track record (well ahead of the MSCI Africa ex South Africa Index) in difficult markets and had a great year in 2017, returning 47.9%.

Other changes

Elsewhere in the portfolio, the managers have been favouring BlackRock Emerging Europe and Verno Capital Growth over JPMorgan Russian, cutting exposure to the latter. BlackRock Emerging Europe may be well known to readers. Verno is a specialist investor in Russia and former Soviet Union countries with over \$1bn under management. The Verno Capital Growth Fund was launched in 2011. It aims to outperform the RTS Index by investing in a portfolio of mainly large and mid-cap stocks selected on a bottom-up basis.

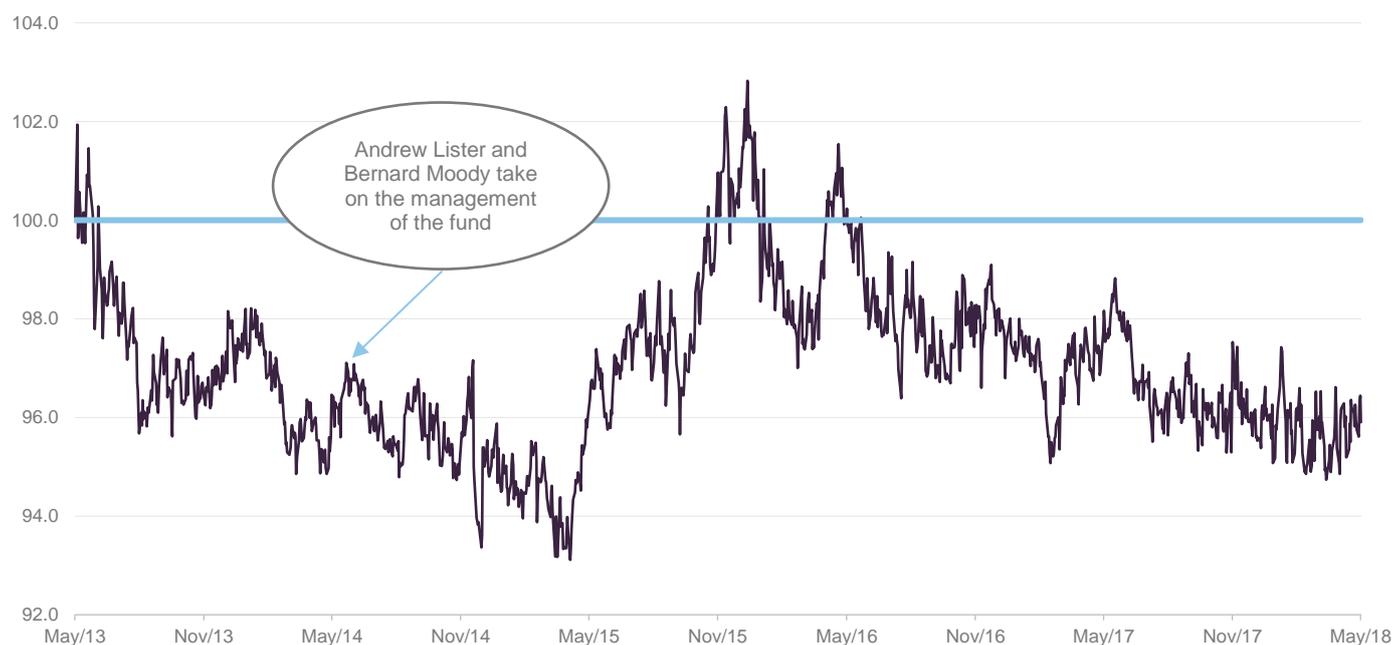
Performance

AEMC has lagged the MSCI Emerging Markets Index by 5.9% over the past five years, as is evident in Figures 6 and 7. Most of the underperformance occurred in 2013 and 2014 and under the previous investment manager. Since Andrew and Bernard took on the fund, it has beaten its peer group and is just 1.4% behind the benchmark index, which has rallied by close to 50%.

The peer-group average comprises the average performance of Fundsmith Emerging Equities, Genesis Emerging Markets, JPMorgan Emerging Markets and Templeton Emerging Markets. These funds' investment objectives closely resemble those of AEMC.

You can access up-to-date information on AEMC on the [QuotedData](#) website

Figure 6: AEMC NAV TR relative to MSCI Emerging Markets over five years to 31 May 2018



Source: Morningstar, Marten & Co

Figure 7: Cumulative performance over periods ending 31 May 2018

	3 months	6 months	1 year	3 years	Since 30 June 2014*	5 years
	(%)	(%)	(%)	(%)	(%)	(%)
Aberdeen Emerging NAV (TR)	(2.6)	0.9	8.1	37.1	48.4	36.3
MSCI Emerging (TR)	(2.4)	2.6	10.6	37.2	49.8	42.2
MSCI World Index (TR)	3.1	3.6	8.2	43.1	66.5	78.6
Peer group avg. NAV (TR)	(1.8)	2.5	10.2	38.4	43.6	34.9

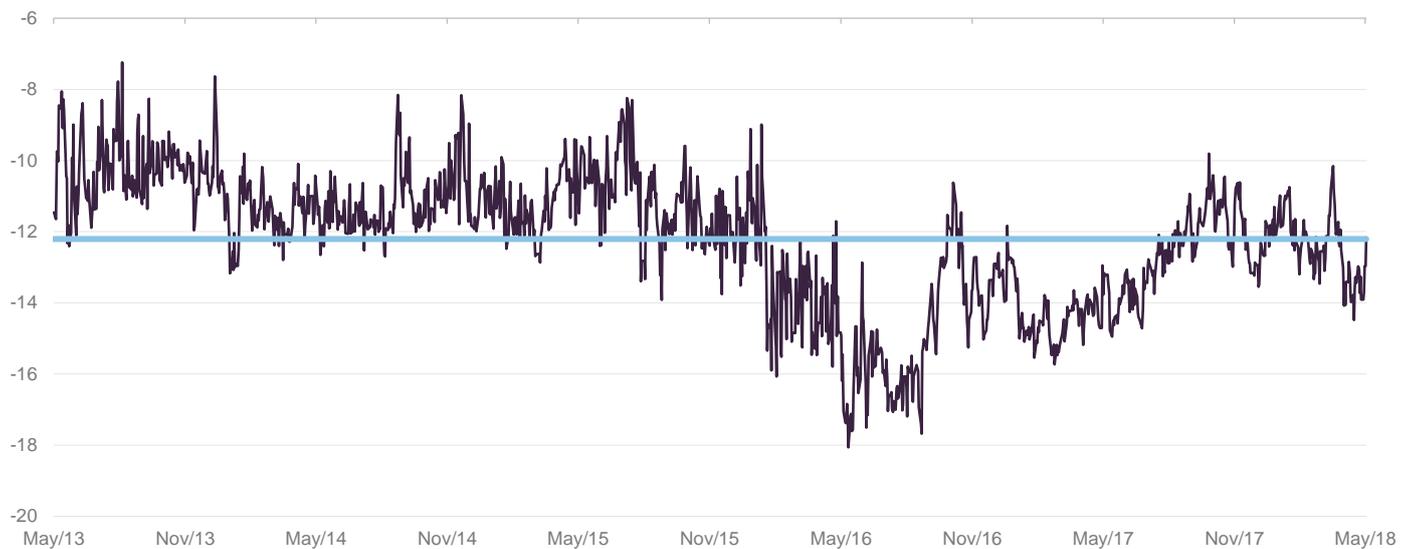
Source: Morningstar, Marten & Co. * date that Andrew Lister and Bernard Moody took control of the portfolio

Since early 2016, the MSCI Emerging Markets Index has been driven higher by its Chinese and technology components. These are areas to which AEMC has an underweight exposure. The portfolio's Indian underweight proved helpful to relative performance but the Russian overweight position detracted. Generally, the managers are unsurprised that AEMC has failed to match the benchmark in a period where growth-style investing has been in vogue. They believe that relative performance will improve when this market phase comes to an end.

Discount

A tender offer, that was announced in February 2018 and concluded in April, resulted in the repurchase of 5,119,633 shares or 10% of AEMC's issued share capital. Following the tender, which was oversubscribed, there are 46,047,096 shares in issue and a further 8,571,411 shares held in treasury. The tender price was 652.6487p, equivalent to a 3.5% discount to the then prevailing NAV. The discount narrowed ahead of the tender and is now in line with its long-term average. Over the past year, it has moved within a range of 14.9% and 9.8%.

Figure 8: AEMC discount over the five years ended 31 May 2018



Source: Morningstar, Marten & Co

Best-of-breed managers investing in dynamic and fast-growing countries

Fund profile

Aberdeen Emerging Markets (AEMC) offers its shareholders access to a range of 'best-of-breed' managers who are investing in some of the most dynamic and fast-growing countries in the world. Investments are made through both open-and-closed-ended funds, blending liquidity and access to a wider range of managers with the opportunity to add value through discount contraction. While benchmarked against the MSCI Emerging Markets Index, asset allocation may differ markedly from the benchmark and is used as a source of alpha generation. Manager selection is also key to the success of the fund and AEMC has investments in a number of funds that the average investor might struggle to access. The fund also offers a yield of 3.4%.

AEMC listed in 1998 as Advance Developing Markets. On 29 December 2015, Aberdeen Asset Management (Aberdeen) acquired Advance Emerging Capital Limited, the then manager of the fund, and the management team moved to join Aberdeen at this time. Andrew Lister and Bernard Moody (the managers) have been involved with the management of the fund since October 2000 and August 2006, respectively. They became the lead managers of the fund on 30 June 2014. They are assisted by Viktor Broczko and Samir Shah (collectively, the team). All of the team members have personal investments in the fund. Aberdeen has considerable depth of investment management and analytical resource in both EM equity and debt which is available to the team.

Marten & Co believes that AEMC is an ideal vehicle for investors who wish to gain access to emerging markets and to a range of talented managers, many of whom might be inaccessible for most UK-based investors.

Previous publications

Readers may be interested to know that Marten & Co published an initiation note on AEMC on 28 September 2017 entitled [Access to a wealth of talent](#). This note has more background information on the structure of the fund, the investment process and the portfolio.

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