

Morning Espresso

Interview with Portfolio Manager Juliana Hansveden Nordea 1 – Emerging Stars Equity Fund

LU0602539602 (BP-USD) / LU0602539354 (BI-USD)

Please note that the conference call occurred on the 30th of September 2020. All market commentary and information refers to the period before then.

Key takeaways

- ESG matters more in emerging markets (EM), in terms of risks and opportunities, than in developed markets (DM).
- While data reliability and availability are improving, it is still crucial to undertake your own analysis and engage with companies on ESG issues.
- Nordea's STARS strategies are at the forefront of fully integrating ESG considerations into fundamental analysis – from idea generation to valuation.
- Resumption of economic activity is continuing in China, with a positive spill over effect to the rest of Asia.

After strongly lagging DM over the past decade, how confident are you of an EM revival?

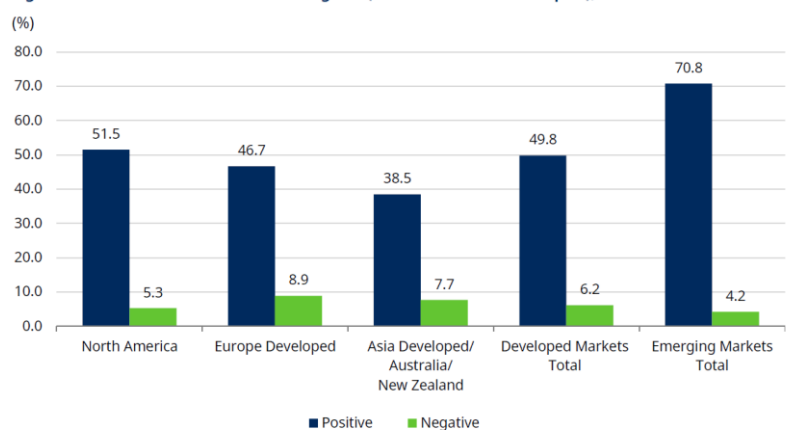
A large part of the EM underperformance can be attributed to the lack of sufficient earnings growth in EM. Fortunately, the universe now looks dramatically different to what it was a decade ago. For example, energy and materials only account for 13% of our benchmark today, down from 30%¹. The increase in more productive areas boosts the prospects for stronger earnings growth and returns moving forward.

Has the importance of ESG within EM remained consistent over this period?

Absolutely. We believe better run companies are more likely to succeed over the long term, which means it is crucial to properly understand and analyse ESG risks. As shown by this meta research – which gathered the results of more than 2000 studies in relation to ESG and its impact on the financial performance of companies – ESG factors were more important in EM than they were in other parts of the world.

In addition to this, the likelihood an investor is exposed to severe ESG risks is much larger in EM, where there is less ESG data published. In general, an EM equity investor is exposed to 14.2% more unmanaged ESG risks than a DM investor.

Figure 1: ESG-CFP* relation in various regions (vote-count studies samples), n=402 net studies



Source: Gunnar Friede, Timo Busch and Alexander Bassen (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies, *Journal of Sustainable Finance and Investment*, 5:4, 210-233, DOI: 10.1080/20430795.2015.1118917. Only ex-portfolio data is shown above. *Corporate Financial Performance (CFP) measures were defined as accounting-based performance, market-based performance, operational performance, perceptual performance, growth metrics and risk measures.

How reliable is the ESG data emanating from companies in the EM universe?

It remains mixed. In some cases, there is little disclosure in relation to material ESG risks. Therefore, before we buy a company, we need to meet – either face-to-face or virtually – and ask questions. We often send our questions beforehand, so the right

¹ MSCI Emerging Markets Index (Net Return) Source: Datastream, as at 30.09.2020

person gets to the meeting and we obtain the information we need. We are fortunate to work alongside our strong in-house Responsible Investments team at Nordea – which means we can draw on our own analysis and not just rely on disclosed data.

Encouragingly, we are seeing improvements in ESG disclosure. For example, Hong Kong Exchanges, one of Asia’s major stock exchanges, is in the process of making ESG disclosure of material issues a responsibility of boards – not just a simple box ticking exercise. In addition, insurance giant Ping An is building an ESG rating system, which it will not only use itself, but also make available to other Chinese investors. As for us at Nordea, as part of our usual engagement efforts, we are working with companies in order to improve disclosures. For example, as part of our engagement with Mexican energy company IEnova, we are tracking its progress in relation to disclosures on climate-related risks.

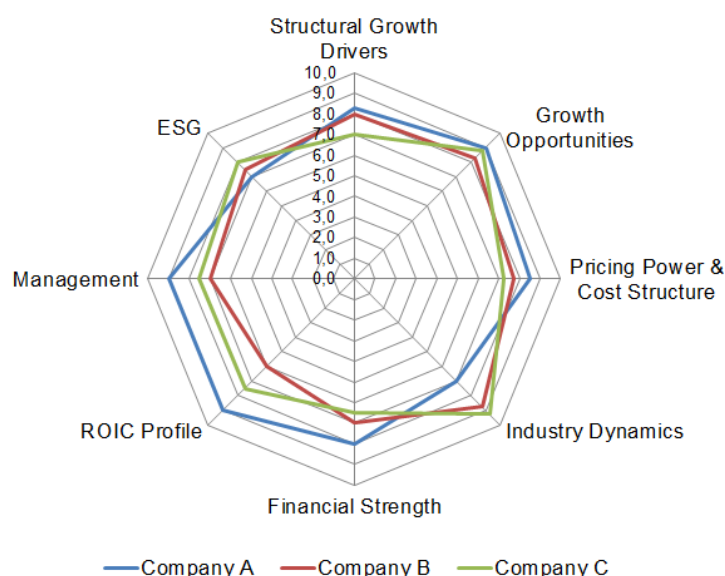
What are the qualities you are looking for when it comes to potential investments?

Firstly, as bottom-up investors, we look to determine whether the company is exposed to structural growth. If the answer is yes, we move onto the ‘key success factors’ element of our fundamental analysis – which includes the ESG analysis. Whenever a member of our team puts together an investment case on a company, all of the points on the diagram on the right must be addressed.

Pricing power and cost structure are very important, as this drives the potential for profitability and likelihood of margin expansion or contraction. Industry dynamics are vital, as leading companies with strong entry barriers are likely to create value for longer. Having said this, we also seek consolidators, companies with the potential for leadership in the future by gaining market share from competitors over time.

Financial strength is about the company having the ability to weather downturns. Therefore, we prefer companies with less debt and strong cash flow generation. We do not settle for companies just growing the top line or bottom line, we want a strong and sustainable ROIC – return on invested capital – or a company with the potential for a strong ROIC down the line. Company management is obviously crucial, in terms of actually running the company and setting the culture. Understanding management is key to obtaining trust and determining incentivisation – in order to see if our interests are aligned.

In relation to ESG, we have spoken previously about our process and the many engagement efforts we undertake side-by-side with our Responsible Investments team. In a nutshell, we are focusing on the material risks for each company, as well as evaluating the sustainability of its business model.



How are EM economies bouncing back from the sharp Covid-19 slowdown?

China obviously took a hit earlier in Q1, but it began to recover in Q2 – just when many other major global economies faced severe economic weakness. Some other Asian economies, such as Taiwan and South Korea, are also ahead in terms of the economic rebound. Encouragingly, while India and Brazil – two of the more problematic EM countries in terms of Covid-19 – are still witnessing high daily case numbers, we are now seeing signs of slowing. As for the Indian and Brazilian economies, power consumption recently returned to pre-pandemic levels, a good indicator that some economic elements are back up and running.

Finally, what have been the key contributors to your performance in this turbulent year?

Pleasingly, our relative performance has been strong. While our benchmark was almost flat over the first eight months of the year, we managed to deliver outperformance of 12.8%.²² The alpha generation combination has been about 75% security selection and 25% asset allocation – which has been a fairly typical split for us historically. The IT sector has been a major contributor, both on security selection and asset allocation, while we also have also seen strong security selection in commercial services. As for individual names, South East Asian gaming and e-commerce company Sea Limited has been a notable contributor, as has Korean group Samsung SDI, which is one of the four global manufacturers of EV batteries.

²² Source: Nordea Investment Management AB. Reference Index: MSCI Emerging Markets – NR Index. Nordea's Emerging Stars Equity Strategy performance calculated gross of fees. **The performance represented is historical; past performance is not a reliable indicator of future results and investors may not recover the full amount invested. The value of your investment can go up and down, and you could lose some or all of your invested money.** Period under consideration: 01.01.2020 – 31.08.2020

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