FUND PROFILE

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# VANGUARD ASSET MANAGEMENT

## VANGUARD GLOBAL EMERGING MARKETS

April 2023

RSMR RATED FUND

OUR RESEARCH. YOUR SUCCESS

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# FUND PROFILE – VANGUARD GLOBAL EMERGING MARKETS

**OUR FUND PROFILES** provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an 'under the bonnet' view of the fund.

In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk

**Vanguard Global Emerging Markets** is a low cost, core global emerging markets fund with a long-term focus, offering access to specialist external fund managers whose interests are aligned with their clients.

The fund combines the skill sets of Baillie Gifford (a growth orientated manager), Pzena (a value orientated manager) and Oaktree (a style neutral manager) with each fund manager responsible for investing one-third of the total portfolio. Baillie Gifford typically look for companies to be industry leaders with significant long term growth potential whilst Pzena seek out companies they believe are undervalued by the market. Oaktree have a core investment philosophy with an emphasis on risk control and consistency.

The combination of these three managers, with different but complementary investment styles, helps widen the opportunity set and results in a well-diversified core holding for investors, offering good value for money.

**Richard O'Sullivan – Investment Research Manager, RSMR**

Richard began his career in financial services in 2012 working for national IFA Chase de Vere before moving to Lift-Financial. Richard joined RSMR in May 2020, immediately prior to which he worked for independent wealth manager Torevell & Partners (formerly Dewhurst Torevell) across several roles including Head of Investment Research. This involved conducting face-to-face meetings with fund managers, carrying out investment research and contributing to asset allocation and fund selection as part of the Investment Committee. He also has extensive experience as a paraplanner and a pension transfer specialist, building bespoke investment solutions for high net worth individuals, trusts and charities.

Richard is a Chartered Financial Planner, a Fellow of the Personal Finance Society and holds the Investment Management Certificate. He graduated from the University of Manchester with a master's degree in Mathematics.

# IA GLOBAL EMERGING MARKETS

The IA Global Emerging Markets sector comprises funds which invest 80% or more of their assets in emerging market equities as defined by the relevant global emerging markets index. The sector contains over 160 funds within the sector with over £33.2bn of assets under management as at February 2023, covering a large variety of investment strategies and styles including active, passive and enhanced index funds. A number of funds adopt style or market-cap based strategies including value and growth-biased themes, market cap focused or multi-cap strategies. The variation in fund styles within the sector can make direct comparison between funds difficult as individual strategies will exhibit different risk and return characteristics depending on market conditions. It is important to recognise this when looking at both absolute and relative performance numbers for funds in the sector.

Historically, exposure to emerging markets has allowed investors access to some of the world's fastest growing countries, but individual growth rates vary. It offers the potential for investors to achieve above average long-term growth, albeit with the likelihood of higher volatility over the short-term. Some exciting investment opportunities have emerged in recent years due to the growth of e-commerce and rising levels of disposable income, providing diversification away from the more traditional export focussed cyclical names in sectors such as energy, resource extraction and manufacturing. Corporate governance varies by country and region, but many companies now have a focus on generating returns for minority shareholders and are exhibiting greater discipline when allocating capital. At present, emerging markets contribute more than half of world GDP as measured by purchasing power parity, but account for a much smaller proportion of the global index. The sector's importance in global equity weightings is likely to increase significantly over the next decade.

China and India, two of the largest index constituents in emerging markets, account for one third of the world's population, and are forecast to account for around 40% of global GDP growth by 2030. China had a challenging 2022 with President Xi pursuing an aggressive zero covid policy and enforcing stringent lockdowns. This hampered economic activity for much of the year, but as restrictions began to ease Chinese equities enjoyed a partial recovery in the fourth quarter. In India, favourable demographics are a tailwind for growth, as are improving returns on capital and corporate governance. Indian companies have always traded on relatively high multiples, but the market is cheaper than it was four or five years ago, and India looks well-placed for more rapid structural growth.

Russia's invasion of Ukraine in February 2022 had a significant impact on eastern Europe as well as creating disruption in global energy markets. The Russian stock market effectively closed to foreign investors overnight, and Russian equities were subsequently removed from most investment benchmark indices. This type of geo-political risk can lead to increased volatility in the sector. The direction of the US dollar can also have a significant impact on asset prices within emerging markets while some countries including Brazil and South Africa can be more sensitive to commodity price movements.

In spite of the increased short-term risks, the Global Emerging Market sector continues to offer excellent long-term potential for skilled active managers.

# VANGUARD ASSET MANAGEMENT

Vanguard Asset Management was founded in 1975. It is a mutual company i.e. it is owned by its US domiciled funds, which are owned by their shareholders. Vanguard's mutual structure aligns the shareholders' interests with those of their investors and drives the culture, philosophy and policies throughout the Vanguard organisation across the globe. The mutual structure also means that clients need not be concerned about the company being acquired by another investment management group.

As at 31 December 2022 total assets under management stood at $7.2 trillion. The company employs over 18,800 people across the globe and is one of the world's largest investment management companies, with a presence in Australia, Europe, Asia and the Americas.

In the UK, Vanguard leverages the scale, experience and resources of their global business. A key aspect of the Vanguard philosophy is their desire to keep costs low to enable them to return profits to investors through lower costs and, as assets under management have increased globally, they have been able to reduce expense ratios for investors in their funds.

Despite being more well known in the UK for their range of index funds, Vanguard have been managing active funds since the firm was founded. At the outset, their fund range comprised entirely active funds, but they established the world's first index mutual fund for individual investors in 1976 and have been a leader in low-cost index investing ever since.

Vanguard established its UK business in June 2009, with a UK domiciled range of index funds, having already established a range of Ireland-domiciled UCITS funds for European institutional investors in 1998. In 2011, they consolidated their European operations in London, launching Vanguard Asset Management Limited (VAM). The European business also has offices in Amsterdam, Berlin, Dublin, Frankfurt, Milan, Paris, and Zurich.

Vanguard serves institutional and retail investors. The retail funds are available on most of the major wraps and retail platforms and are predominantly made available to retail investors via independent financial advisers, private wealth managers and fund platform providers.

# VANGUARD GLOBAL EMERGING MARKETS

| | |
|---|---|
| **Manager** | Baillie Gifford (33%)<br>Pzena Investment Management (33%)<br>Oaktree Capital Management (33%) |
| **Structure** | UK Regulated OEIC UCITS compliant |
| **IA Sector** | IA Global Emerging Markets |
| **Launched** | 25 May 2016 |
| **Fund Size** | £300.5 million as at 28 February 2023 |

## Fund Manager

In their active fund range, Vanguard often make use of the skills of external portfolio managers who they believe are capable of generating strong long-term investment returns versus benchmarks and peers. In this fund, they have combined three traditional bottom-up managers with different but complementary styles – one growth orientated (Baillie Gifford), one value orientated (Pzena) and one style-neutral (Oaktree) – to deliver a core global emerging market equity mandate.

Vanguard's Portfolio Review Department (PRD) has responsibility for implementing the manager selection process, which includes evaluating external managers for potential mandates, as well as internal portfolio managers, such as the Quantitative Equity Group and the Fixed Income Group. Internal portfolio managers are subjected to the same level of scrutiny as external fund managers.

When evaluating current and prospective managers, Vanguard's PRD use a framework focusing on quantitative and qualitative criteria, not short-term performance. Sometimes the process results in the selection of internal fund management teams, otherwise Vanguard uses the expertise of external portfolio managers, provided they are philosophically aligned with Vanguard. Using external managers gives Vanguard access to a much broader talent pool than they would otherwise have in an area where skill is critical. Investment mandates are only awarded to external fund managers if the PRD has conviction in their ability to generate long-term outperformance.

## Baillie Gifford

Baillie Gifford is one of the UK's largest private investment managers. The firm was founded in 1908 in Edinburgh where it continues to have its headquarters. The firm is a private partnership wholly owned by the current partners who all work full time in the business. The partnership structure affords the company significant stability and independence, which means they focus on the best interests of their clients. Their sole business is investment management with more than half of funds under management in international and global portfolios. Vanguard has been using Baillie Gifford as a sub-adviser since 2003.

**Mike Gush,** the lead manager on the fund, graduated with a MEng in Mechanical Engineering from Durham University. He joined Baillie Gifford in 2003 and worked in the UK and Japanese equity teams before moving to the emerging markets equity team in 2005. Mike recently became a partner at the firm and is a CFA Charterholder.

**Andrew Stobart** is the other investment manager working on the mandate. Andrew graduated with an MA in Economics from the University of Cambridge. After three years working in investment banking in London, he joined Baillie Gifford in 1991 and worked in the Japanese, North American and UK equity teams, before joining the emerging markets team.

In addition to the fund managers there are another six members of the Baillie Gifford emerging markets team.

The majority of the firm's investment teams are based in Edinburgh, which means that the emerging markets equity team is able to draw on the expertise of the wider Baillie Gifford regional equity teams, international and global portfolio construction groups, and global sector research specialists. They work in open plan offices and share ideas informally and more formally in a series of pre-arranged meetings.

## Pzena Investment Management

Pzena began managing assets in January 1996 and now runs portfolios for endowments and foundations, pension plans, and for individual investors from around the world. They are based in New York and have offices in London and Melbourne for business development and client service. Vanguard has been using Pzena as a sub-adviser since 2005.

There are three co-portfolio managers working on this fund, all with joint decision making responsibility. All decisions must have the unanimous consent of the team. The three managers are Alison Fisch, Rakesh Bordia, and Caroline Cai.

**Allison Fisch** graduated with a BA in Psychology from Dartmouth College. She has been in the investment management industry for 20 years and has worked at Pzena for 18 years.

**Rakesh Bordia** graduated from the Indian Institute of Technology with a Bachelor of Technology in Computer Science & Engineering. He has been in the investment management industry for over 20 years and has worked at Pzena for 15 years.

**Caroline Cai** graduated with a BA in Economics from Bryn Mawr College and is a CFA charterholder. She has 20 years investment management experience and has worked at Pzena for 15 years. She is responsible for the day-to-day monitoring of the portfolio.

The team leverages the global research analysts at the firm and has one analyst as a dedicated resource. They have over 20 research analysts based in New York, covering industries at the global level and working closely with the portfolio managers to provide company and sector-level research.

## Oaktree

Oaktree Capital Management was established in 1995 by a group of individuals who had been investing together since the mid-1980s. The firm now has over 900 employees in 18 locations across the globe including their headquarters in Los Angeles, London, Hong Kong, Tokyo, Singapore, Seoul, Beijing, Dubai, and Shanghai.

Oaktree manage investments for global pension plans, corporations, endowments and foundations, sovereign wealth funds and primary state retirement plans in the United States. Vanguard has been using Oaktree as a sub-adviser since 1996.

Oaktree's Emerging Markets equity strategy is managed by Frank Carroll with the assistance of Janet Wang, following the retirement of longstanding co-manager Tim Jensen in June 2020. Janet Wang has been at Oaktree for 18 years.

**Frank Carroll** joined Oaktree in 1999, having been head of trading for Columbus Advisors for two years. He was previously head trader for Latin American Fixed Income at Banco Santander and Bankers Trust. For six years prior to joining Bankers Trust, he was an emerging markets trader for Salmon Brothers. He received a BA degree in history from Fairfield University.

**Janet Wang** joined Oaktree in 2002 and holds a degree in finance and marketing from Boston College and an MBA. from Columbia Business School. Prior to Oaktree she worked for ABN Amro Asia as a research assistant with specialisms in building materials and airline sectors. Janet is fluent in Mandarin.

The investment team is divided along industry lines for research purposes so analysts can develop an in-depth knowledge of a sector and compare valuations across national markets. Sometimes analysts can identify major industry trends that will affect a sector's operations or valuations.

## Fund Objectives & Targets

The fund is designed to deliver an increase in the value of investments over the long-term (more than 5 years).

The fund's benchmark is the FTSE Emerging Markets Index, and it has a target tracking error of between 2.5 and 4.5%. The fund's active share will be in the region of 75-80%.

# INVESTMENT PHILOSOPHY & PROCESS

The fund combines three traditional, bottom-up fund managers – one growth orientated, one value orientated and one style neutral – to deliver a core global emerging markets mandate. Vanguard seek deep, committed relationships with investment managers to focus on long-term returns.

### Baillie Gifford

Baillie Gifford apply a consistent investment philosophy across all of their funds. This is implemented via a bottom-up fundamental analysis of companies, leading to a portfolio with typically low turnover and a growth bias. The process looks to identify stocks which will grow faster than the market over the longer term. Baillie Gifford believe that the market is poor at estimating the full growth potential of individual companies due to a focus on short term concerns and failing to appreciate the extent and sustainability of their competitive advantage. Baillie Gifford instead look to the long term, typically taking a 3-5 year view and as a result portfolio turnover is relatively low.

Fundamental analysis sits at the core of the investment process and is the source of added value for clients. The firm uses a broad framework to structure their research and to identify investment opportunities. The framework considers opportunity, execution and valuation.

Opportunity relates to a company's opportunity to deliver enhanced returns by assessing the industry or market in which it operates and whether the company possesses any clear and sustainable competitive advantages.

Execution is about considering the ability of a company to capitalise on the opportunity identified above. The managers analyse the financial structure of a company, in particular whether it can fund growth from internally generated cash flow. They form judgements on the strategy taken by the management and follow the actions of leaders closely, seeking tangible evidence that they run the business in the interest of shareholders.

Baillie Gifford consider the valuation the market has placed on the company's shares to determine the extent to which others have already appreciated the strengths they have identified. Expectations about changes in fundamentals are equally important.

Sell decisions are generated by the frequent re-examination of their holdings. They look for any adverse change in the fundamentals of a business, a loss of confidence in management, or where valuations fully reflect the manager's long-term view. The lead manager has ultimate discretion when making investment decisions.

### Pzena

Pzena are classic value investors, seeking to buy good businesses at low prices. Their universe comprises the 1,500 largest companies from non-developed markets based on market capitalisation that are underperforming their historically demonstrated earnings power. They apply intensive fundamental analysis to these companies to determine whether the problems that caused the earnings shortfall are temporary or permanent.

Pzena manage relatively concentrated portfolios to focus on holdings that will generate meaningful excess returns for long-term investors.

Whilst they are primarily fundamental investors, they recognise that country factors can play a significant role in stock performance in emerging markets, and they have incorporated the use of key macro data as an additional input into the research process when assessing risk.

At the screening level, they use discount rates tailored to each country to take into account differing levels of country specific risk embedded in stock valuations. They also consider factors such as the current levels of, and changes in, interest rates, international reserves and exchange rates. Country credibility ratings and country valuations (both relative to other emerging markets as well as to the country's own history) are also a factor.

The research is conducted in the context of whether they would 'buy-the-whole-business' and the investment team is well suited to such an approach. Team members have run businesses, been management consultants, accountants, lawyers, engineers and private equity investors prior to joining the firm. The common skill set is their ability to assess whether a management's strategy is likely to succeed.

Meeting company management is considered to be an important part of the research process and the research process culminates in a full day meeting with senior company management. They have approximately 350 meetings per year, of which about half are with existing holdings. New research visits are typically on-site, while refresher visits can take place either on-site or at their offices.

### Oaktree

Oaktree are style neutral and characterise their investment process as being opportunistic and driven by bottom-up stock selection. Their investment philosophy emphasises the importance of risk control, consistency, knowledge and specialisation. They are not advocates of market timing and they do not believe that macro-forecasting is critical to investing.

They will invest in both high growth and cyclical stocks that trade at a discount to their model, depending on the opportunities presented to them, and are not beholden to a specific style. They conduct their own in-house fundamental research, supplemented with independent sources of information and broker research. They seek to identify stocks trading at attractive valuations relative to expectations. In addition, they seek to avoid stocks that are overvalued with flawed business models. Company meetings are an important part of the process to validate the fundamental research.

The investment team looks at the cash flows generated by a company, forecasts the sustainability of these cash flows, and evaluates the capital investment opportunities available to that company. They then discount these cash flows at an appropriate rate and compare this intrinsic value to the market value of the stock.

Macro allocations are predominantly determined by the bottom-up stock selection process but the overall risk within the fund is managed to ensure that the resulting country allocations are acceptable.

The team build in-house models and formulate investment theses to support their recommendations, identifying companies that they believe will perform better than market expectations.

The backbone of their research is the Internal Research System, their database of emerging markets companies. All meetings, contact, or other material issues with the companies and their management are written up and posted onto the system which now has over 15 years of history and over 57,000 records. The database is continually updated and accessed daily by the analysts and portfolio managers to evaluate how the companies have changed over time and to assess their relative attractiveness in the current market.

## External Manager Selection Process

Vanguard's sub-adviser selection and monitoring process is led by Chief Executive Tim Buckley, with all appointments individually approved by the Vanguard board of directors.

Vanguard's Portfolio Review Department (PRD) identifies investment managers who they believe are able to deliver strong long-term investment returns for clients and with whom they can develop and maintain long-term relationships. In doing this, they look for firms which have a similar culture to Vanguard.

A number of tools are used to identify manager candidates, including the PRD's proprietary database, external databases and Vanguard's existing network of sub-advisers. Each year, Vanguard conducts hundreds of meetings with potential investment advisers from around the world.

The factors taken into account include:

- The Firm – Is it stable? What is the ownership structure? Does this align with client interests? What are its financial and asset trends? How does it incentivise its employees?
- The People – What is the firm's staff tenure and experience? Does it have depth and stability of talent?
- The Investment Philosophy – Does it have an enduring, easily articulated philosophy shared by its investment professionals?
- The Investment Process – Is it stable/proven? Does it generate a portfolio consistent with stated philosophy?
- The Investment Portfolio – does the investment portfolio clearly reflect its philosophy and process? Does it have consistent characteristics over time?
- Performance – Does the firm have a history of competitive results versus benchmarks and peers over the long term? Has it demonstrated success in

different market environments?

If an investment manager is worth pursuing as a candidate to run a mandate, PRD members meet the firm's executives, portfolio managers, traders and other essential personnel to gather more data and insight. The information they seek includes organisational and ownership structure, succession plans, history, code of ethics, written compliance practices and trading-allocation procedures.

The PRD analyses the data on all the candidates and narrows down the list, summarising the pros and cons of each choice. One more level of evaluation takes place – a final candidate review by the Global Investment Committee (GIC) chaired by Tim Buckley and including a number of Vanguard managing directors. The GIC meets with each candidate and then selects the manager(s) to recommend to the Vanguard Board of Directors.

Using qualitative and quantitative metrics, Vanguard aim to combine managers who offer different investment styles and characteristics, such as combining small firms with large firms, and concentrated portfolios with diversified portfolios. Each individual manager must possess a different investment process and source of long-term outperformance. They combine managers who complement one another in style and seek to reduce short-term volatility whilst still capturing the outperformance of each sub-adviser.

Vanguard has been employing a multimanager approach since 1987. All funds, whether managed internally or externally, are entirely under Vanguard's control. Having conducted extensive due diligence on the sub-adviser and mandated them to run the funds, Vanguard are not involved in the day to day decision making (e.g. stock selection) on the fund.

Vanguard's oversight operations aim to ensure that each fund stays true to its mandate, and that each external manager continues to have the traits and processes that prompted Vanguard to hire them in the first place. With several layers of scrutiny, they monitor all fund portfolios across multiple criteria, with three Vanguard bodies performing fund / portfolio monitoring:

- Vanguard Board of Directors (which provides fiduciary oversight of funds and final approval of decisions about funds and advisers)
- Global Investment Committee (which undertakes ongoing fund oversight and decision making)
- Portfolio Review Department (which has full time responsibility for fund oversight and manager research)

## Risk Management

Risk management responsibilities for the traditional active funds lie both with Vanguard, and with the external sub-advisers. Ultimately, Vanguard assumes the responsibility for the risk management of the fund but the combination of the Vanguard risk management team and those of the external fund managers provides more than one level of risk control.

Within Vanguard's Portfolio Review Department (PRD), the Oversight & Manager Search team is primarily responsible for adviser oversight and for ensuring that a fund's managers maintain their stated strategy on behalf of Vanguard's Board and Global Investment Committee (GIC). The team comprises over 20 experienced investment professionals with academic and professional investment experience including 10 CFA Charterholders. The PRD applies the same oversight to Vanguard's internally managed mandates as it does to those managed by third parties. The PRD meets weekly, and their work is reviewed by the GIC and the Board.

### Baillie Gifford

Bailie Gifford's dedicated Investment Risk Team is entirely independent of the global equity investment managers. The team uses a range of tools and measures to analyse the risk within portfolios including 'active share', delivered tracking error and the spread of stock specific risk. Importantly, their investment risk team is also experienced in assessing the methodology and limitations of the different tools, and how to interpret their output in different market conditions. Overall, Baillie Gifford believe that these tools can add value to the investment monitoring process if used intelligently and pragmatically. The Investment Risk Team reports formally every quarter to the investment managers, client service team and Baillie Gifford's Investment Risk Committee (chaired by an investment partner).

### Pzena

Several different approaches to risk management are applied to the Pzena investment strategies. One of them being that within their products, they use maximum allowable weightings for securities and sectors in order to ensure that no one security or sector can cause significant risk to the portfolio. On a weekly basis, senior management review the portfolios to ensure that they comply with their mandates and they are in line with the current investment strategy. Risk management is a very important factor in Pzena's investment strategy, with various reports used in its tracking.

The risk controls are tracked through multiple reports by Pzena's portfolio administrators. In addition, every week there is a review meeting which includes all of Pzena's portfolio managers. During this meeting, the portfolios and their underlying holdings are reviewed to ensure that individual securities have not become so large as to add unnecessary risk to the portfolio.

### Oaktree

Oaktree's risk management philosophy is to construct highly diversified portfolios across multiple industries and countries and to avoid concentrated bets that could adversely impact performance. They do not manage the portfolio to a specific risk target, but risk management is a central aspect of their process. They manage correlation risk by measuring exposures relative to the benchmark at the company, country and industry level, and they have established a variety of guidelines for maximum and minimum levels. In addition, they are mindful of risks in other forms, such as fraud and the potential lack of transparency in financial reporting. The co-managers and the experienced team of research analysts continuously monitor the composition of the portfolio to manage risks.

## ESG Integration and Engagement

### Baillie Gifford

Baillie Gifford became signatories of the UN Principles for Responsible Investing in 2007 and ESG considerations are built into their investment process to ensure the long-term investment case remains robust in the face of an ever-changing background. Baillie Gifford actively engage with their investee companies on issues such as sustainability, board structure and environmental impact. There is also a dedicated Governance and Sustainability team who work alongside the fund managers on these issues and assist them in utilising proxy voting to effect change.

### Pzena

The team understand that ESG considerations can have a material impact upon the performance of a business and as such integrate ESG analysis at every stage of their investment process. Where an issue is identified, Pzena will conduct a review to investigate its materiality to the investment case as well as understanding whether there is an opportunity to add value in rectifying the issue. Engagement with company management occurs throughout the due diligence process.

### Oaktree

As a bottom-up stock picking strategy, ESG factors form part of the initial fundamental analysis conducted on each company considered for inclusion in the portfolio. Oaktree have a proprietary ESG analysis methodology which forms part of their investment process and can inform the managers as to the sustainability of the underlying business model. This includes a detailed questionnaire investigating potential issues and company management are engaged so that Oaktree can understand the strategy employed to deal with any material problems. There is an ESG committee within Oaktree which helps to scrutinise the research carried out and develop an action plan to rectify concerns.

# PAST & CURRENT POSITIONING/STRATEGY

## Baillie Gifford

Baillie Gifford manage one third of the fund and look to make long term investments in well-managed businesses which enjoy sustainable, competitive advantages. They are growth orientated investors but categorise different types of growth with a view to investing in stocks that more traditional growth orientated investors could miss.

In 2022, the orientation towards growth detracted from performance with several sectors such as technology weighing on performance but also offering up many new opportunities. In the first quarter of 2022 the team initiated a position in Anker, a consumer electrics company in China, in the belief that the company has created a strong reputation for making quality products at reasonable prices and that the firm had been overlooked by many market participants. Baidu, the leading search engine in China, was purchased in the second quarter on share price weakness and the managers feel that there was significant value yet to be realised in its artificial technology division as well as an underestimation of the value of the firm's investment holdings by the wider market. An area of strength for Baillie Gifford throughout 2022 was an overweight in energy and this was further bolstered by the addition of PTT E&P, a Thai upstream oil & gas business, in the third quarter. The firms' operations are primarily based in south-east Asia but there is growth in the international asset base. The volume growth and strong cash flow characteristics of the business should be a source of strength in the future. Samsung Electronics was a key detractor in the second quarter of the year, but the fund managers retain conviction in the holding due to a belief that long-term demand for the memory chips and other complex devices that the company manufactures will be a driver of returns. Similarly, First Quantum Minerals, a copper miner, also detracted at several points in 2022 but was retained given the belief that the company is a best in class operator and the long term demand and supply dynamics of the copper market will prove positive.

The major disposals in 2022 included the sale of online gaming company Huya due to a belief that the changes to the regulatory backdrop were not conducive for the business. Dada Nexus was sold due to not effectively integrating technology into the firm's grocery business, hampering returns on investment. In the third quarter, Vale SA was sold due to concerns that the long-term demand dynamics in the industry would be challenging, caused in part by a slowdown in construction in China. The managers also held Russian company Sperbank, whose capital value was written down to zero due to the war in Ukraine.

Baillie Gifford's believe that negative expectations are already priced in to emerging market equities. Challenging macroeconomic conditions should mean that those companies that have a strong balance sheet and favourable business model will be well placed to navigate a less favourable backdrop and stock picking will strongly affect returns in the sector. The team remains focused on investing to grow businesses for the long term and holding them through difficult market environments.

## Pzena

Pzena is a deep value investor and benefitted strongly from a favourable trading environment for such stocks in 2022, with security selection also adding value in sectors such as consumer discretionary.

Alibaba was added in 2021 on share price weakness and the managers topped up the position in the second quarter of 2022 as shares retreated further. The managers believe the company to be significantly undervalued, particularly for its strong position in China's nascent cloud computing industry. This was partially funded by a reduction to Czech utility firm Cezto. In the third quarter a position was initiated in Peruvian bank Credicorp after several factors led to a fall in the share price, offering an attractive entry point. Brazilian utility Light SA was sold in part due to the departure of the CEO. Ping An, China's largest life insurance business, was added in the fourth quarter due to the share price falling in response to sales dipping due to Covid-19 lockdowns limiting face-to-face sales. The Pzena fund managers believe that company management are making positive progress in streamlining their workforce and should be well positioned going forwards. Turkish car manufacturer Tofus Turk Otomobilon was sold on the back of share price strength following strong results. The value of Lukoil, the Russian oil company, was written down to zero following the invasion of Ukraine.

The Pzena team are confident that the portfolio offers good value given the underlying fundamentals of the companies held.

### Oaktree

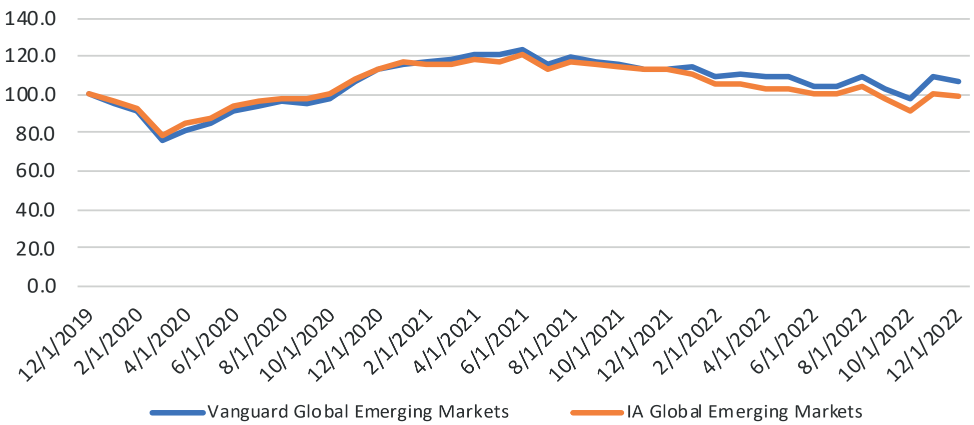
Oaktree manage one third of the portfolio and are style neutral. They characterise their investment process as being opportunistic and driven by bottom-up stock selection. They are price sensitive and believe recent price dislocations should offer up some attractive opportunities to upgrade the quality of their underlying holdings.

2022 was a generally strong year, with the portfolio outperforming its benchmark in three out of the four quarters. Early in the year the team sold Chinese real estate firm Shimao Group due to the company failing to meet its debt obligation, whilst Chinese aviation company Air China was added on share price weakness. JD Logistics was sold in the second quarter given continuing pressure on Chinese internet names, with alternatives in the sector looking more attractive on a relative basis. A position in Brazilian utilities firm Centrais Electricas Brasileirasas was initiated following the company listing on the stock market as part of a privatisation drive in Brazil. The team believes the firm will be able to realise significant value by cost cutting and improving profitability. In the third quarter a position was initiated in Chinese giant Tencent as share price weakness offered an attractive entry point. Bao Steel was sold as, despite offering an attractive valuation, the team could not see a near-term catalyst for increasing demand in the face of slowing construction and car sales. The team participated in the IPO of Americana Restaurants in the fourth quarter, a company which operates a franchising model for brands such as KFC and Pizza Hut in the United Arab Emirates. The team believes the company has a good business model that generates positive cash flow coupled with a solid growth strategy. Hong Kong-based airline Cathay Pacific was exited as the investment thesis had played out and there was likely to be limited upside in the short to medium term.

Oaktree expects central banks in developed markets, such as the US and Europe, to continue to raise interest rates, which will prove to be a headwind for growth sectors. Conversely, the team believes value sectors should continue to benefit from the current environment, particularly if they have solid balance sheets and are cash generative. The team is optimistic that the reopening of China's economy following easing of lockdowns will provide increased demand for commodities and a boost for companies in cyclical sectors. This should also be positive for emerging markets as a whole, given their increased exposure to commodities.

# PERFORMANCE

### 3 year performance to 31 December 2022




Source: Vanguard Asset Management

The fund was launched in May 2016 and the underlying portfolio managers have long-term track records when it comes to managing global emerging market mandates, albeit in very different styles.

The performance since inception demonstrates the results of the fund's structure. Despite the rotations between growth and value seen in the broader market, the fund has delivered consistently strong performance. It has done this with less risk than its peers, as measured both by downside volatility and maximum drawdown.

The fund has recovered from the first quarter of 2020 when it underperformed its benchmark. Since inception, this is one of only two quarters where all three parts of the fund have simultaneously failed to beat the benchmark, partly due to a materially lower weighting to China but also a relatively high weighting to areas such as oil & gas. The coronavirus outbreak led to a significant bifurcation in the sector with the Chinese markets falling by around 4% compared to drops of around 50% in Brazil and Russia. A narrow group of stocks avoided the full impact of the sell-off, creating a wide dispersion of returns across the peer group.

Although a tough year for absolute performance in the face of rapidly rising interest rates and persistently high inflation, relative performance in 2022 was strong and the fund was ahead of the average peer in the sector. The Baillie Gifford portion of the fund struggled due to the tilt towards growth orientated equities which performed poorly, but the strength of combining three different investment managers within the fund meant that strong returns from Pzena and Oaktree more than compensated for this.

Since the lows of the Covid-19 pandemic the fund has performed very well and achieved better performance than the sector average by a sizeable margin and over the three years to 31 December 2022 is ahead of the sector average.

Due to the nature of the bottom-up stock picking employed by the three portfolio managers, there will be times that the fund exhibits markedly different short-term performance to the benchmark. Whilst this can mean periods of underperformance, this differentiation can also be a key driver of long-term returns.

All active funds experience periods of underperformance and despite its strong record so far, Vanguard Global Emerging Markets is of course no different. It is intended as a long-term core investment for those with a preference for active management.

# SUMMARY & EVALUATION

Vanguard Global Emerging Markets is a low cost, core global emerging markets fund with a long-term focus, offering access to specialist external fund managers whose interests are aligned with their clients.

The fund combines the skill sets of Baillie Gifford (a growth orientated manager), Pzena (a value orientated manager) and Oaktree (a style neutral manager) with each fund manager responsible for investing one-third of the total fund. Baillie Gifford typically look for companies to be industry leaders with significant long-term growth potential whilst Pzena seek out companies they believe are undervalued by the market. Oaktree have a core investment philosophy with an emphasis on risk control and consistency.

Growth tends to outperform during rising markets, but also falls more heavily in declining markets. Timing these rotations can be very difficult and the combination of these three managers, with different but complementary investment styles, helps widen the opportunity set and results in a well-diversified core holding for investors, offering good value for money. All three teams have established credible track records through the consistent application of their investment processes over time.

The Ongoing Charges Figure of 0.78% ensures that the fund has a significantly lower changing structure than the majority of actively managed global emerging market funds which are typically 20 basis points or more higher. Through compounding, the effect of lower charges should have a positive effect on long-term performance. This fund will typically have an active share of 75-80%.

The make-up of emerging markets continues to evolve and whilst these areas were once dominated by materials and commodities, the current sector mix is much broader, with technology and financials now much more important. Vanguard Global Emerging Markets is designed to carefully manage the balance between value and growth. All of the managers have historically demonstrated the ability to contribute long term outperformance through bottom-up fundamental analysis above and beyond that achieved simply by their style being in favour.

# ABOUT US

Our Research. Your Success.

Established in 2004 RSMR provides research and analysis to firms working across the UK's personal financial services marketplace.

Our work is completed with total impartiality, without any conflict of interest and delivered to a high professional standard by a team of experienced and highly qualified people.

## Working with advisers

We provide specialist research, analysis and support to a diverse range of financial advisers and planners helping them to deliver sound advice to their clients, backed by rigorous and structured research and due diligence.

The main regulatory body in the UK, the FCA, states that personal recommendations made by advisers should be 'based on a comprehensive and fair analysis of the relevant market' and this has led to closer scrutiny of the whole advice process. Our solutions are designed to help advisers meet these challenges whilst recognising that advisory firms require a range of flexible options that best meet their own business needs and those of their clients.

## Working with providers

We work with all the leading fund groups, life and pension companies and platform operators across the financial services sector offering straight forward and pragmatic advice to help add value and improve their business performance and efficiency whilst treating customers fairly in line with FCA requirements.

## Ratings

Our innovative ratings are now recognised as market leading and cover a broad area of investment solutions including single strategy funds, SRI funds, Multimanager and multi-asset funds, DFMs and investment trusts. Our familiar 'R' logo is now recognised as a trusted badge of quality by advisers and providers alike and a 'must-have' when selecting funds. Our ratings are founded on a strict methodology that considers performance and risk measures but places a greater emphasis on the ability of fund managers to continue to deliver performance in the years ahead. based on our in-depth face-to-face meetings with fund managers across the globe.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your clients and your business.

**Our research. Your success.**

# NOTES

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