

PM Spotlight: At Home in Emerging Markets

Derrick Irwin, CFA Senior Portfolio Manager

Derrick Irwin, senior portfolio manager and co-head of Intrinsic Emerging Markets Equity at Allspring, has always felt at home in emerging markets. So have his team members.

Q: WHAT ATTRACTED YOU TO WORK IN EMERGING MARKET EQUITIES?

A: I grew up in an investing household. My father was among the first U.S. international investors, when even investing in Japan seemed quite exotic. He eventually ran a fund that invested in South African equities, which was probably one of the only strategies of its kind at the time. So, non-U.S. markets were always really interesting and exciting to me, first from a macroeconomic perspective and then bottom up. I was an economics and geology major, and after college, I moved to investment banking in the global power space. At the time, emerging economies were just beginning to access U.S. markets, and utilities and power producers were among the first listed companies to come out of places like China, India, and the former Soviet Union.

I ended up doing transactions all over the world and learned a lot about different cultures. I worked in Asia—particularly Singapore and China—South Africa,

and Australia. I knew I wanted to stay in international finance, so I did a number of research jobs on the sell side before landing at Allspring.

Q: HOW DO YOU ACHIEVE CONVICTION IN PORTFOLIO HOLDINGS WHEN THE COMPANIES ARE SO FAR FROM YOUR HOME BASE?

A: First, structurally, we have very low turnover—only about 20%. We approach research from a long-term perspective, so we get to understand a company's business model, its cultural dynamics, and long-term capital plans. That helps bridge the distance. Now after the COVID-19 pandemic, having Zoom and Teams means we can join a video call with Mumbai just as easily as one with Memphis.

Second is traveling to companies. It's hugely valuable for our team members to visit companies on the ground to get a real sense of the market and develop relationships from the CEO down to the operating level. At times we're doing more site visits than someone managing a domestic portfolio. Our team members are from emerging market countries, and they have a real passion for the markets they cover.

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Sometimes traveling on those dusty back roads leaves us with interesting stories. I've been in Nigeria when it was recommended that we have armed guards with us at all times. On my very first trip to India, I landed in Mumbai and hopped into a cab to the city. We got into an accident halfway there and in the middle of rush hour—is it ever not rush hour in Mumbai—with lots of yelling and drama as you can imagine. For the most part, though, emerging market countries are modernized and run efficiently. There are certainly challenges, but the benefits of cultural immersion, talking to locals, seeing the country, and understanding what's really happening on the ground, rather than just reading about it, outweigh those challenges.

Q: HOW DOES YOUR INVESTMENT APPROACH INCORPORATE QUALITY AND VALUATION?

A: The critical element is our sequential approach. We believe it's essential to first demonstrate a high degree of conviction in a company's underlying quality before doing the valuation work.

Most investors tend to look at quality and valuation on a sliding scale. Take, for example, a cheap company with a turnaround story. Investors might think they have a margin of safety from value. Or consider a company that's struggling with mediocre management but is in a growing industry; investors might feel they have a margin of safety from growth. We don't think that way. Our strict sequential focus of determining whether it's a good company first is really at the heart of what we do. It doesn't matter whether the company is in China or South Africa. This allows us to build a portfolio of companies that balances quality and valuation but does not skew one way or another—a truly core emerging market portfolio.

The most important element is our team. This is one of the most experienced and thoughtful teams I've seen in the industry. We have exceptionally low turnover—we haven't had a departure since 2015—and every person was hired because we think they're a good fit for our investment philosophy and strategy. We have one investment philosophy and one investment process that everyone is steeped in, by virtue of being here most of their career. I think that's our secret sauce.

Q: AMID ALL OF THE UNCERTAINTY AROUND TARIFFS AND TRADE, ARE YOU SEEING ANY HINTS OF RESHORING SUPPLY CHAINS?

A: I think many emerging market countries learned their lesson and started looking at their supply chains in 2017 and 2018. China, of course, leads the pack. But this time around, it could be harder for them to simply reconfigure supply chains as they did in previous cycles. I think the reshoring trend will continue; we will see more investment in manufacturing facilities and increased technology transfer to help countries move up the value chain. Differences between tariff rates will make it much cheaper to maintain facilities in countries like Indonesia or Turkey.

Twenty years ago, most emerging market countries counted the U.S. or European Union as their biggest trading partner. Now that's changed to China being the dominant trading partner for many if not most countries around the world. So, the current trade tensions are accelerating a longer-term trend that, I believe, benefits emerging market economies with greater access to cheaper goods and fewer barriers to trade. As trade barriers rise in the global north (developed markets), they may continue to fall in the global south (emerging markets), creating new opportunities for cross-border growth.

Q: WHAT EXCITES YOU MOST ABOUT FUTURE EMERGING MARKET OPPORTUNITIES?

A: The emerging markets are around 40% of global gross domestic product and are projected to continue growing. Along with that growth, we see advancements in technology, manufacturing, energy production, and financial inclusion. Three or four years ago, for example, South Africa was in the grips of power outages. Those days are largely behind us, in part because the government finally addressed power production issues and in part because companies and households invested in solar panels provided by Chinese companies. Solar panels are everywhere—from large warehouses to small villages and individual homes.

There's also been a technological explosion over the past 20 years, and now many emerging countries are actually ahead of the U.S. in things like banking and financial services technology. That kind of financial inclusion can really snowball. Government policy also matters a lot, and while there are still some significant issues, I think they're largely on the right path.

I also believe the relative investment risk has narrowed between emerging market and developed market equities. Economic conditions like current account deficits reflect that, and I think the bond market agrees—debt ratings are, on average, about as high as they've ever been. As concerns around lofty valuations, unpredictable trade policies, and the future of the U.S. dollar have risen in the U.S., we believe there's potential for a real sea change in investor sentiment and portfolio allocation toward emerging markets.

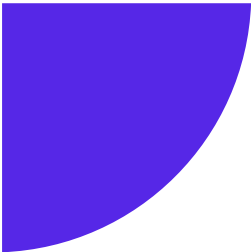
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