

Q2 2020 WEBINAR TRANSCRIPT

THE WORLD'S GROWTH ENGINE

The effects of Covid-19 have reverberated around the world. Here, investment managers Tom Miedema and Jamie Zegleman discuss the impact of Covid-19 on emerging economies in particular. Having been the primary driver of growth in today's global economy, they consider what role these markets will play in any post-pandemic recovery.

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Tom Duff: Welcome to Walter Scott's quarterly client webinar. My name is Tom Duff and I work in the Walter Scott Client Service team. I'm joined today by Jamie Zegleman and Tom Miedema, two experienced members of the Research team who for the last five years, in addition to their research responsibilities, have held the role of championing the Walter Scott Emerging Markets Strategy.

Today we're going to discuss the impact that the Covid-19 pandemic is having on emerging markets. Our Emerging Markets strategy was established in 1997 and is managed by the Research team, using the same philosophy, process, team-based decision-making as all other strategies at Walter Scott. Emerging markets have been a key growth driver for the world economy, and this is reflected in the geographic revenue exposure to emerging markets within our core Global and International strategies.

Today the number of new cases of coronavirus across emerging market countries far exceeds the number of

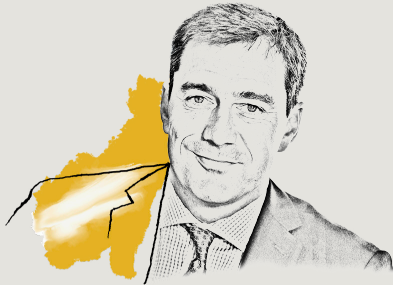
cases reported in the developed world. So turning to you first, Tom, perhaps you could set the scene for us and give us a picture of how this virus has impacted the emerging world.

Tom Miedema: You can broadly split the emerging world into two groups. Those countries that have contained Covid-19, and those that have widespread infections through the population and are then trying to mitigate that impact.

As a Research team, we've been talking about this dichotomy really since very early in this pandemic. If you look at countries like China, Taiwan, South Korea, Vietnam, the virus has not spread broadly through the population; they've done an excellent job of containing the

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WALTER SCOTT



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Tom and Jamie share responsibility for Walter Scott's Emerging Markets strategy within the Research team.

virus. This success is not a coincidence. They all have experience of SARS (severe acute respiratory syndrome); they have robust protocols around testing, track and trace, and quarantine, that swung into action very rapidly. There's been a high level of compliance and awareness in the population, and these have been key to this positive outcome.

If you then look at countries like Brazil or India or Indonesia, you see a very different picture. While we have seen various short-term measures, sustained lockdown is not a viable option for many of these countries due to high population density and the economic reality that many people cannot afford to stop making money.

Tom Duff: Is this changing how you think of emerging markets from an investment perspective?

Tom Miedema: Clearly, this will have a big influence on the near-term outlooks for different countries. A lot of this has been reflected already in the prices of both equities and currencies, so while it's easy to be negative on the prospects for the worst-affected countries, it would be wrong to write them off for the next few years.

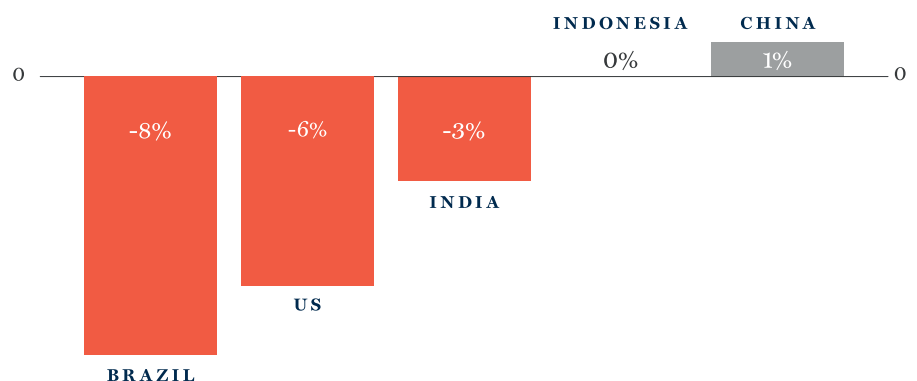
Demographics should play a big role. Mortality from Covid-19 is highly concentrated in the population over 65, and these countries are fortunate to have a much smaller percentage of their population in that age bracket.

Starting this crisis later will also help them. The standard of care for Covid-19 treatment has already improved significantly. Finally, supply chains are better prepared, so essential supplies and equipment should be more readily

available. Unfortunately, we're likely to see a humanitarian tragedy in the developing world. However, these countries will recover.

There are still a lot of uncertainties. China, Taiwan, South Korea, and Vietnam have proven very successful in coping with the pandemic and should do very well going forward. Many other countries will face a challenging time, but ultimately they'll get through this crisis and continue on their positive trajectory.

GDP GROWTH 2020, %



Source: WorldBank

Tom Duff: Turning to you, Jamie, maybe you could shed some light on the economic impact of the virus across emerging markets?

Jamie Zegleman: The World Bank has forecast that emerging market GDP will contract by around 2.5% in 2020. Although this is actually a fair bit better than the 6-7% decline that they're projecting for advanced economies, it would still be the first contraction amongst emerging markets in 60 years.

There's actually quite a wide range of experiences across emerging market countries right now. North Asian emerging markets responded quickly and pro-actively to the virus and have hopefully already seen the worst of its economic impact.

Unfortunately, the same cannot be said for many other emerging market nations who are generally earlier on in their own outbreaks.

Tom Duff: You mention that many north Asian countries are perhaps through the worst of the crisis. Are you seeing this reflected at a company level?

Jamie Zegleman: Encouragingly, the experience in parts of Asia and in particular in China is arguably the best across the world right now. It's also

"This crisis has really highlighted the fragility of global supply chains"

where the majority of emerging market economic output is actually located.

Looking at China specifically, whilst the economic hit in the first quarter was certainly deep, the rebound has surprised many in terms of its speed and its scale so far, and that's something we've been hearing repeatedly actually from our companies when we've had interactions with them.

We've heard positive commentary from various international consumer brands in China. It's also been corroborated by some of the Chinese businesses we're speaking with. It's not just been the consumer companies though. One international elevator company has also spoken of seeing a rapid recovery in China, suggesting there are some signs of life in the important construction industry as well.

Tom Duff: Tom, you've done a lot of analysis of technology and supply chains in your time with Walter Scott.

A number of commentators are talking about Covid-19 leading to a reversal of globalisation, or at least maybe a slowdown in the process. Where do you think we are in this regard and what might be the impact in the developing world?

Tom Miedema: This crisis has really highlighted the fragility of global supply chains. That is true of many industries globally, and I think that, once the dust has settled on this crisis, many companies will turn to reassessing their own supply chains. That's certainly something we've been talking to management teams about.

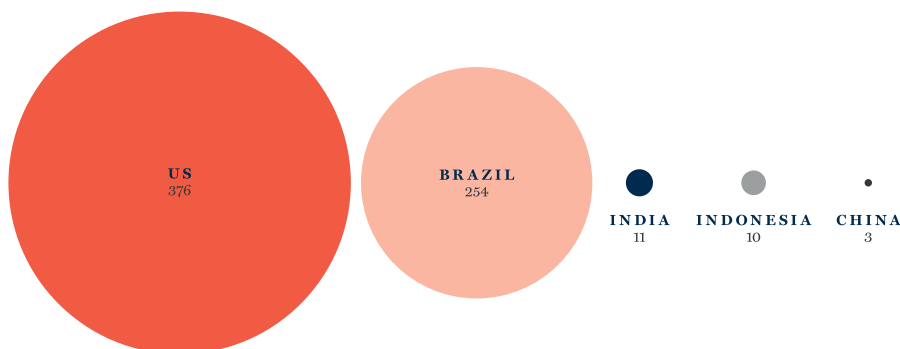
The result seems likely to be some kind of reversal in those uber-efficient supply chains that are common today. Some manufacturing will likely relocate as a result, either because products are too important to take the risk with, or because these products are highly strategic and the world has woken up to the risk inherent in those supply chains.

If we think about strategic industries, the semiconductor supply chain is highly concentrated in Asia. Politicians are waking up to the strategic nature of the industry, and there's clearly pressure on the industry to diversify its manufacturing footprint. This is not going to be easy and it will not happen quickly, but it's something that we've been thinking about and debating a lot in the team.

On the other hand, many things are not going to change materially. The benefits of trade are real, it's not just textbook theory, and these benefits have been shaping industries for many decades. In many cases, countries or companies have a natural economic advantage in the production of certain goods.

In many other industries, the developing world has cultivated highly efficient and specialised clusters in manufacturing and service ecosystems: smartphone manufacturing in China,

DEATHS PER 1M POPULATION



Source: Worldometers (25/06/2020)

or footwear production in Vietnam. It would be exceptionally difficult and inefficient to replace this in the developed world.

Irrespective of manufacturing location, automation and digitisation trends in manufacturing are likely to continue to evolve at a rapid pace, and this will be to the benefit of many companies in the developed and developing worlds.

From an investment perspective, we do not believe these changes will derail the long-term prospects for the developing world in aggregate. Low-value manufacturing is something we have limited exposure to, and this is not by accident. There are numerous examples of emerging companies that add a lot of value to their products and services, and we think they will come out as winners from these trends as they evolve.

Tom Duff: From what you're saying, Tom, it sounds like Covid-19 is only furthering the adoption of digital technologies. Jamie, digital is an area of research you've been particularly close to. Do you see this happening in emerging markets too?

Jamie Zegleman: The meme "Who led the digital transformation of your company?" has been doing the rounds for a while now on the internet and really captures perfectly how Covid-19 is impacting corporations. In a world where your customers can't come into your shops or your employees can't come into your office, you need a robust digital backbone to continue doing business, and corporations are investing in this right now.



WHO LED THE DIGITAL TRANSFORMATION OF YOUR COMPANY?

A. CEO

B. CTO

C. COVID-19

Source: Digital Transformation Quiz – Susanne Wolk (Twitter)

The circumstances are forcing us all to adopt new technologies. Satya Nadella, the Microsoft CEO, described it perfectly when he said that we are seeing "two years' worth of digital transformation in two months."

From emerging market countries' perspective, I would argue that they were at the forefront of many of these trends already. They've often been seen to develop faster and differently to the more developed markets, and that's because they are able to jump straight to new technologies.

We think that Covid-19 reinforces and accelerates these trends as people adapt

to lockdown and get used to doing more and more things online.

Tom Duff: Thank you, Tom and Jamie, for your insights today. It's fascinating to see how the developing world is responding to this crisis and adapting to the greatest economic challenge we've seen in many years. There's certainly plenty for investors to think about, but some exciting new opportunities to consider too, particularly in technology.

In the months ahead, we'll be continuing our conversations with management teams around the world as they navigate their way to the new normal.

IMPORTANT INFORMATION

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