



# A Watershed for EM Investing?

## Reflections on the Ukraine Crisis

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# Crisis Implications: Themes in EM Investing

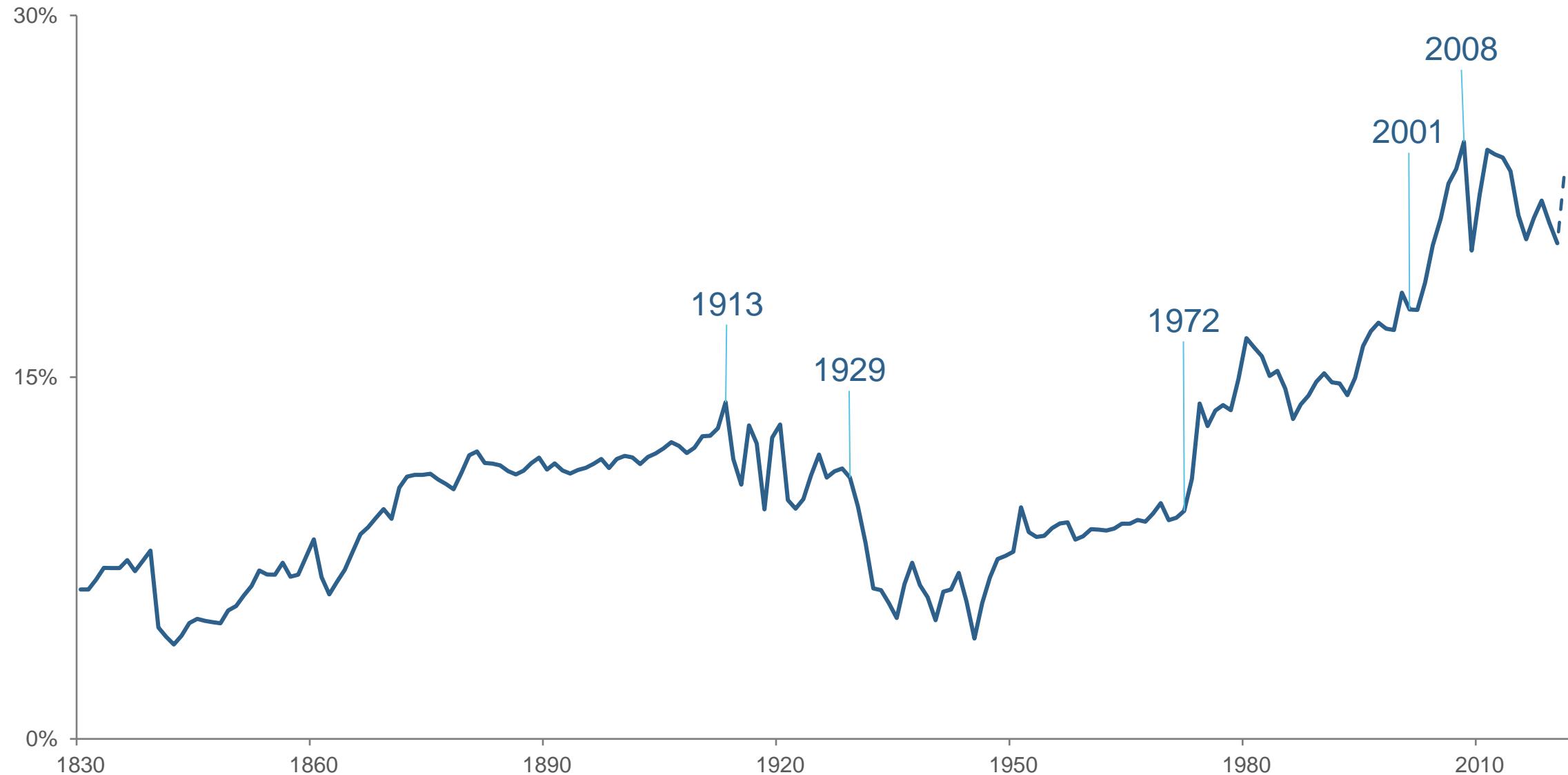
- De-globalization or Re-globalization?
- Benchmark Energy Exposure: Feature or Flaw?
- Managing Geopolitical Risk



# Deglobalization or Reglobalization?

# Globalization: Long-Term Perspective

GLOBAL EXPORTS OF GOODS AS % OF GDP, 1830 - 2021



Source: Acadian based on data from ourworldindata.org (1830-1982), IMF Direction of Trade Statistics Exports and World Bank GDP (1982-2020), and Acadian (2021). For illustrative purposes only.

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# Russian Oil: Likely to Flow *Somewhere* at Some Price

PRICE DISCOUNT: RUSSIAN CRUDE VS. BRENT

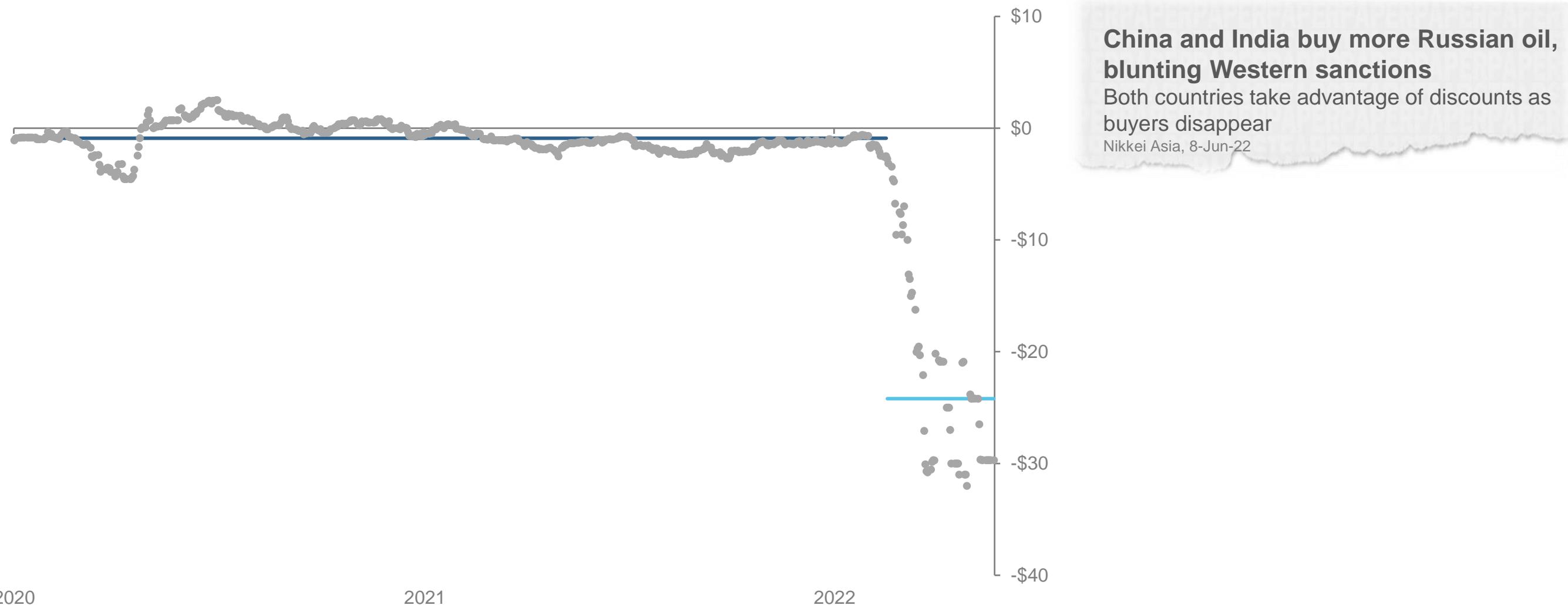
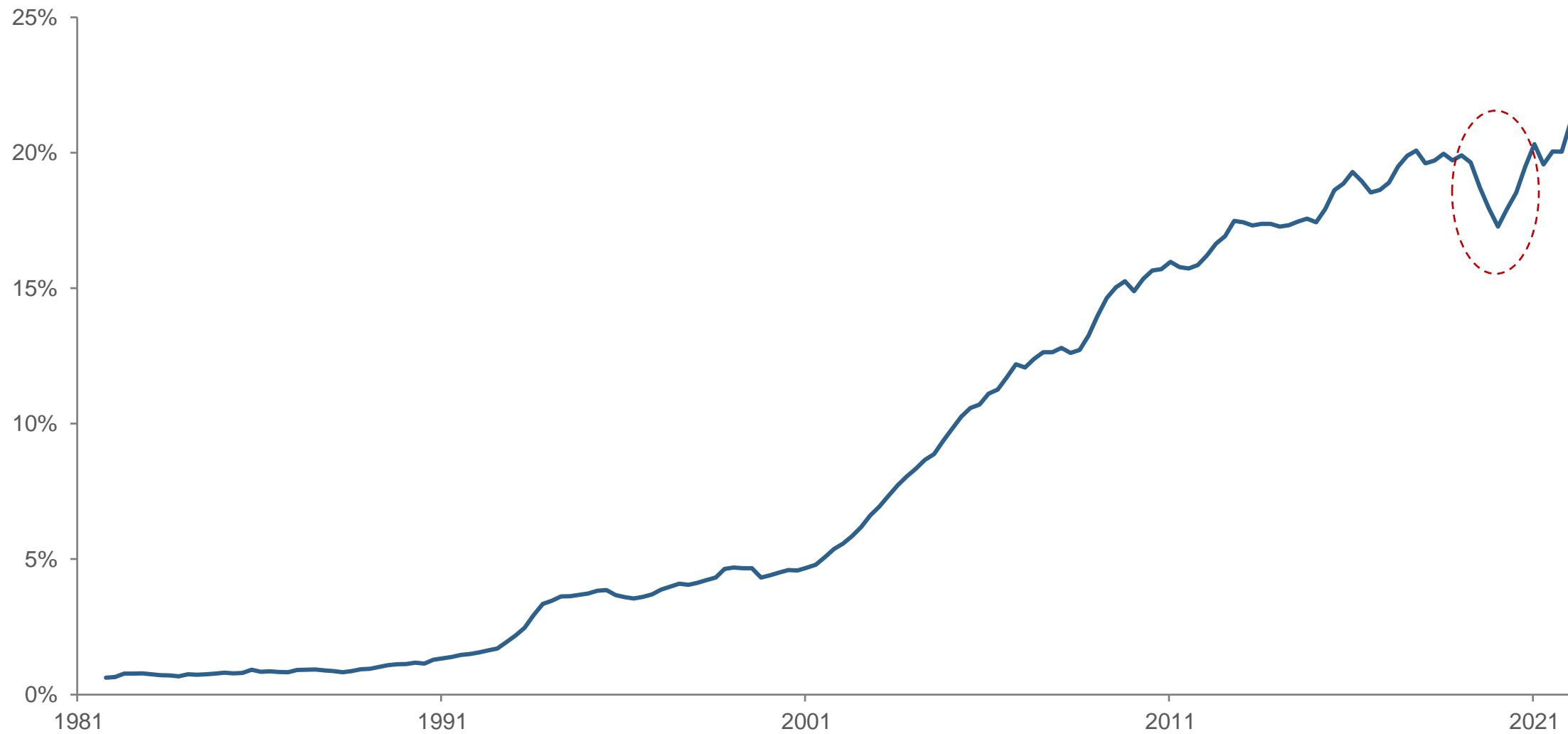


Chart shows discount of front month Ural Crude to Brent. Pre-Invasion average (dark blue) covers Jan-15 - 16-Feb-22. Post-invasion average (light blue) covers 16-Feb-22 - 23-May-22. Source: Acadian based on data from Bloomberg. For illustrative purposes only.

# Decoupling: Harder than it Might Seem

U.S. IMPORTS FROM CHINA

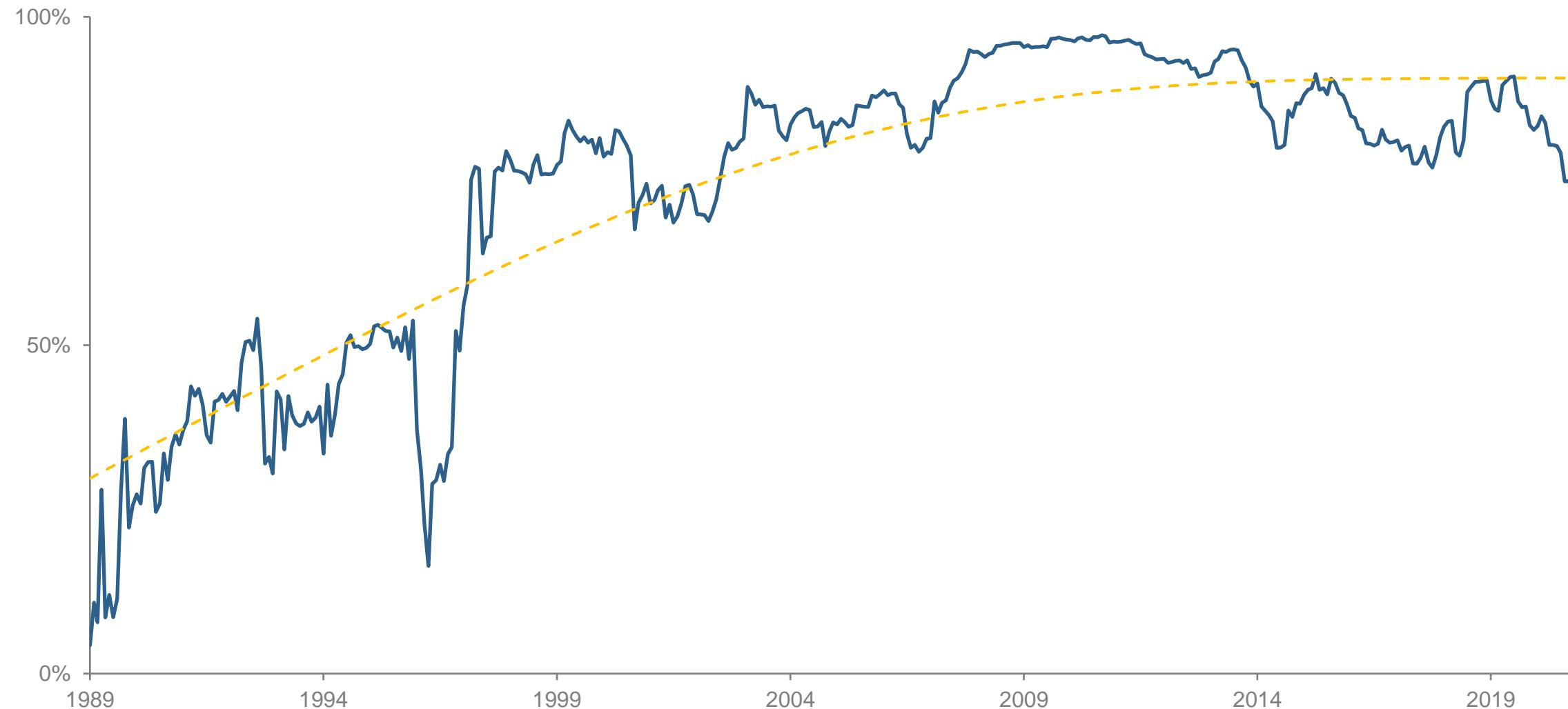


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# Global Integration of Emerging Equity Markets

FRACTION OF EM BENCHMARK RETURNS VARIATION EXPLAINED BY GLOBAL RISK FACTORS



The trend line represents a filtered (Hodrick-Prescott filter) version of the rolling fit. Sources: Acadian Asset Management LLC, MSCI Copyright MSCI 2022, all rights reserved. Unpublished. PROPRIETARY TO MSCI. For illustrative purposes only.

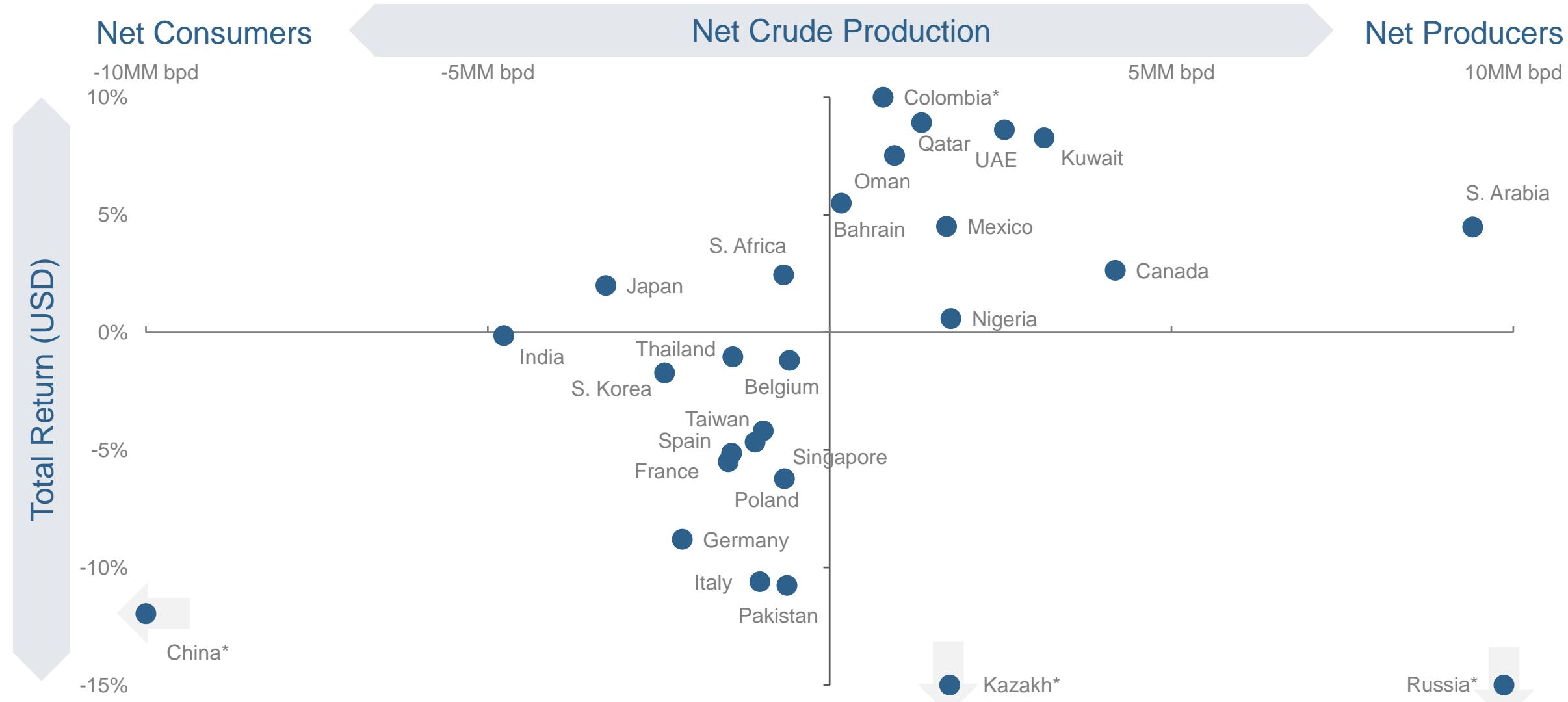
- ▶ EM equities: In aggregate, likely to remain well integrated with global markets
- ▶ Prioritize “distinctiveness” in EM allocations (e.g., China A and other “locally-oriented” stocks)
- ▶ Reglobalization may alter benchmarks

# Benchmark Energy Exposure: **Feature or Flaw?**



# Country Energy Exposure and Returns: Crisis Outset

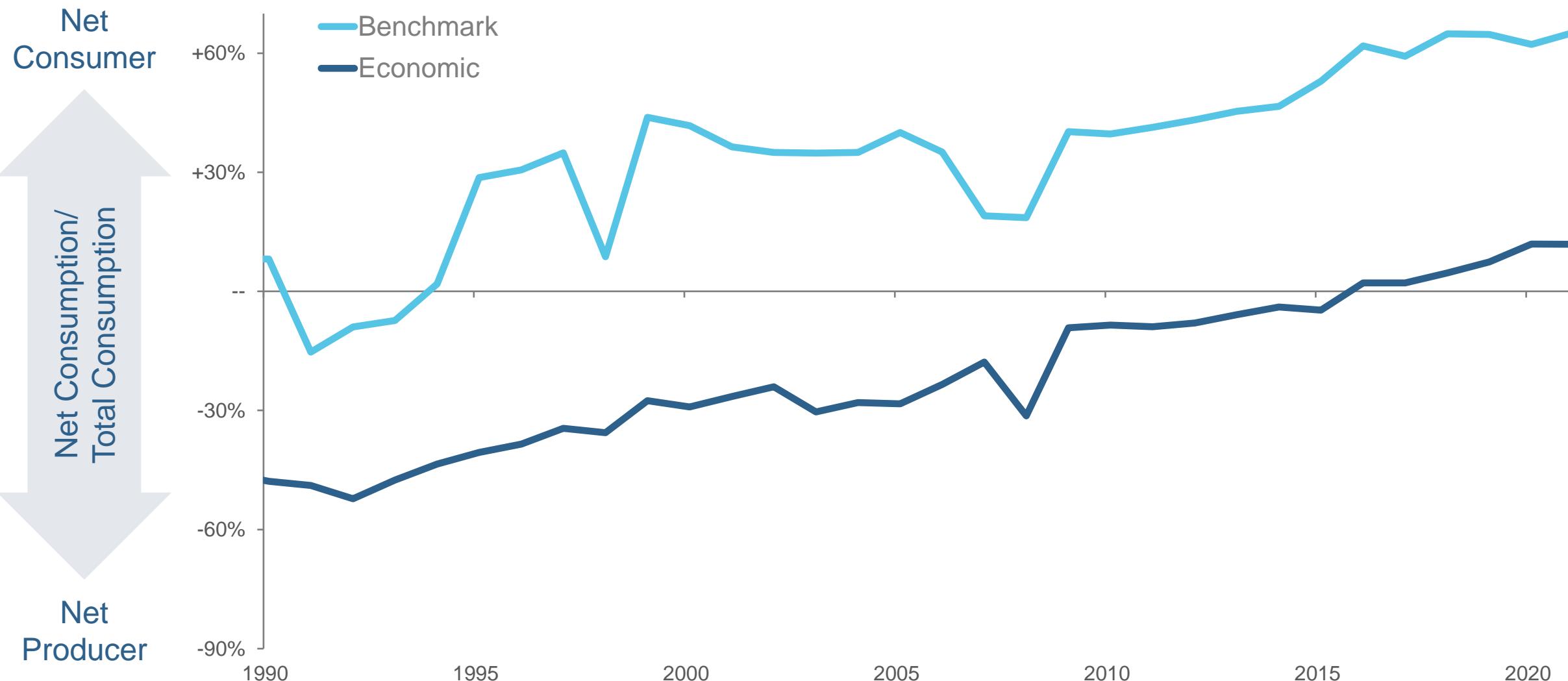
RETURNS OF SELECTED COUNTRY INDEXES, 16-FEB-22 – 23-MAR-22



\* Returns and Net Consumption bounded for clarity – Net consumption: China 13.9M bpd, EM 43.6M bpd bounded at 10M bpd, Returns: Russia (-100%), Kazakhstan (-35%) bound at -15% and Colombia (+16%) bounded at +10%. Chart shows the scatter between production (positive) and consumption (negative) as of 2020 for major net consumers (>70% net exposure) and top producers on the horizontal axis vs USD net total returns to corresponding MSCI country equity indexes from 16-Feb-22 to 23-Mar-22 on the vertical axis. Sources: Acadian Asset Management LLC, MSCI. MSCI data copyright MSCI 2022. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI. For illustrative purposes only. It is not possible to invest directly in an index. Past results are not indicative of future results.

# EM Energy Exposure: Benchmark vs. Economic

NET CRUDE CONSUMPTION, THROUGH 2021



Net crude consumption = consumption – production as a percent of total consumption aggregated across countries in the MSCI EM Index as of Feb 28, 2022. Sources: Acadian Asset Management LLC, MSCI. MSCI data copyright MSCI 2022. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI. For illustrative purposes only. It is not possible to invest directly in an index. Past results are not indicative of future results.

# Prelude to the Crisis: A Protracted (Relative) Energy Decline

WEIGHT IN MSCI EM INDEX



Shaded area shows exposure to the Energy sector (left axis) and exposure to Russian equities (right axis) in the MSCI EM Index. Sources: Acadian Asset Management LLC, MSCI. MSCI data copyright MSCI 2022. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI. For illustrative purposes only. It is not possible to invest directly in an index. Past results are not indicative of future results.

- ▶ Critically review “passive” EM benchmarks as active strategies
- ▶ Well-conceived active may provide guardrails against behavioral errors and concentration
- ▶ Consider custom benchmarks

# Managing Geopolitical Risk



# Geopolitical Risk: A Defining Characteristic of EM

CUMULATIVE WEIGHT IN MSCI EM INDEX (FROM LEFT)

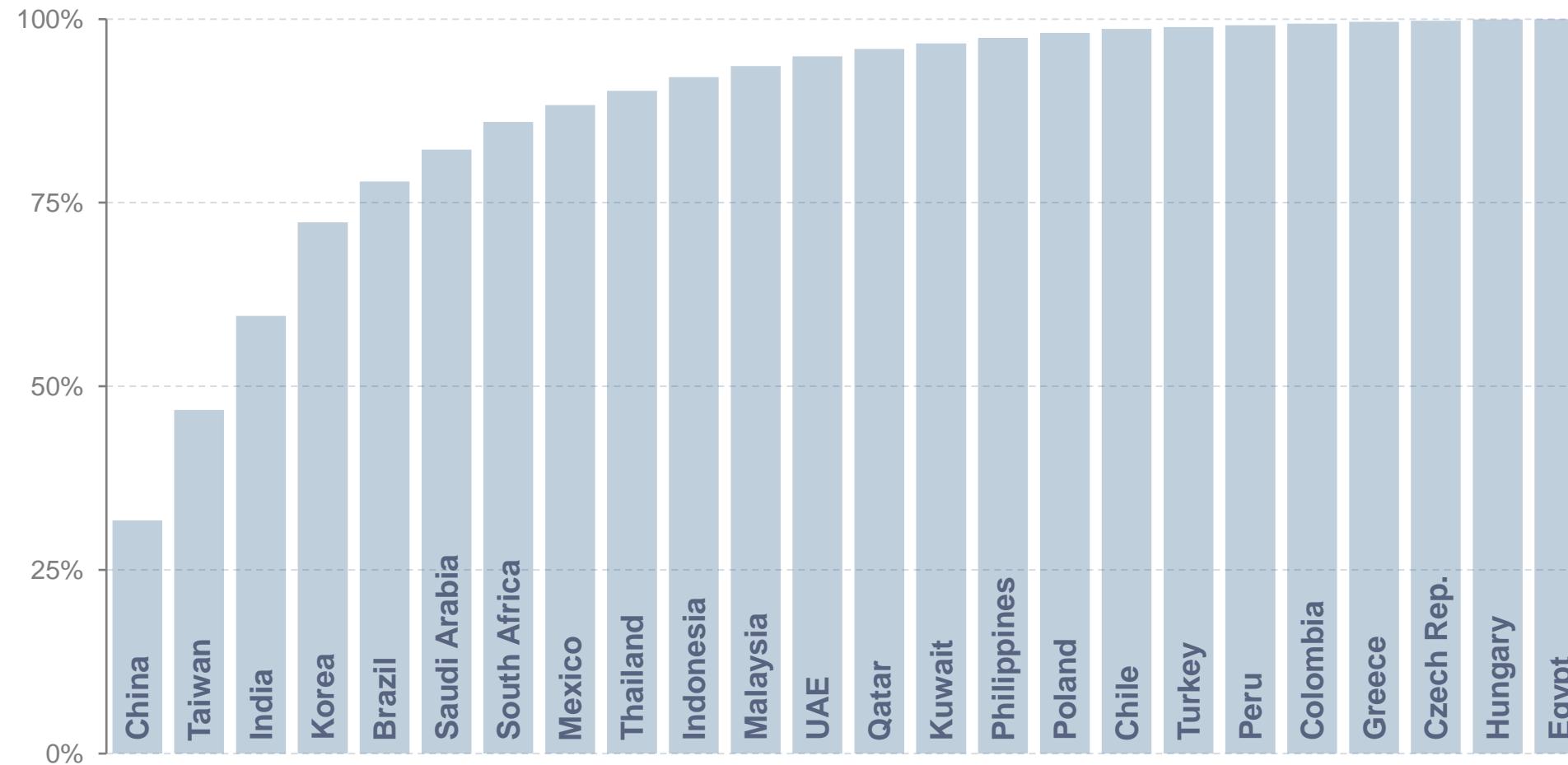


Chart shows cumulative weights by country in the MSCI EM Index as of February 28, 2022. Country corruption scores as of December 31, 2021. Political Stability and Absence of Violence/Terrorism data represents World Governance Indicators, 2021 update. Sources: Acadian Asset Management LLC, MSCI and Transparency International, CIA Factbook, World Bank. MSCI Copyright MSCI 2022. All Rights Reserved. Unpublished. PROPRIETARY TO MSCI. For illustrative purposes only.

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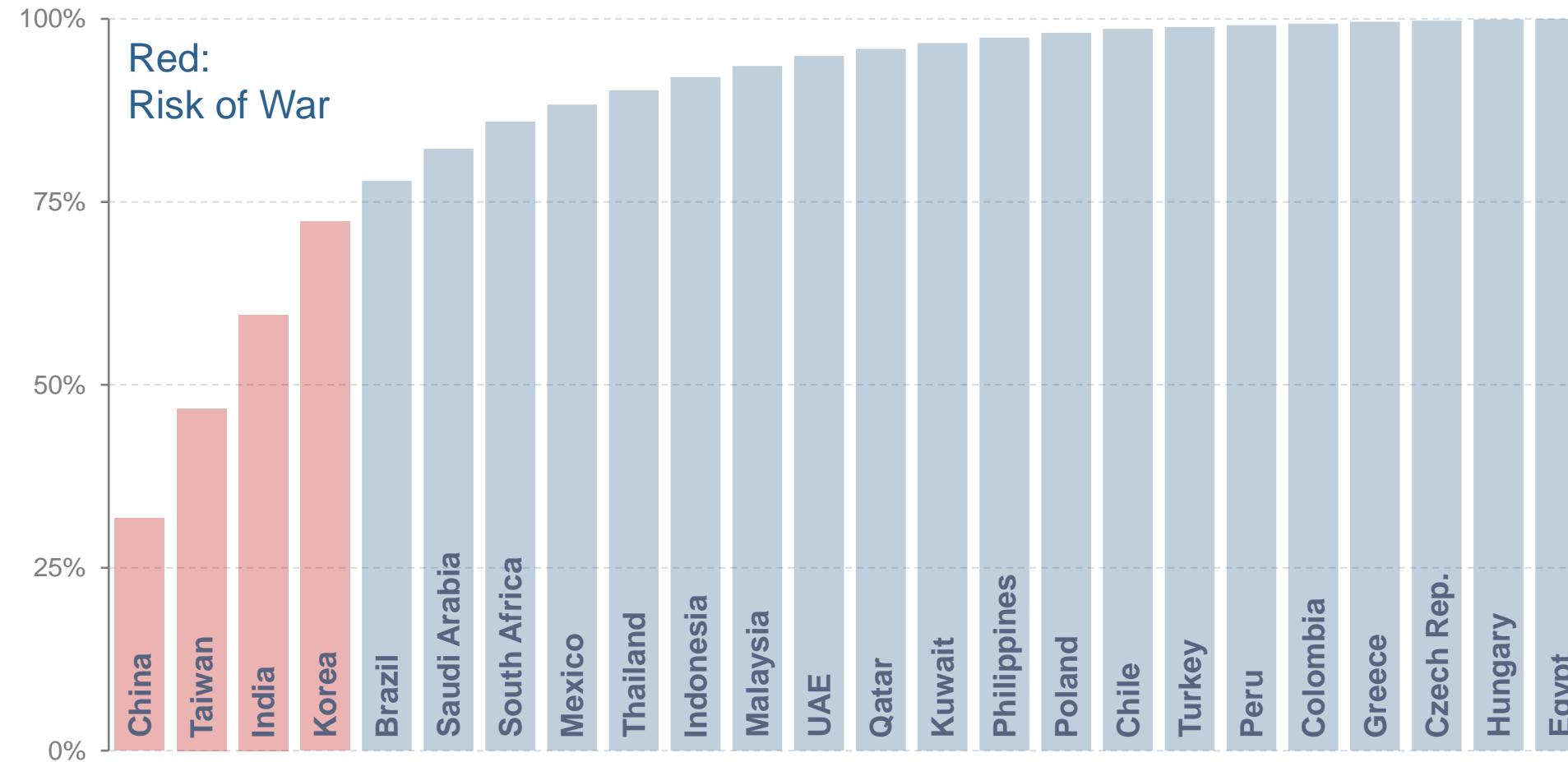


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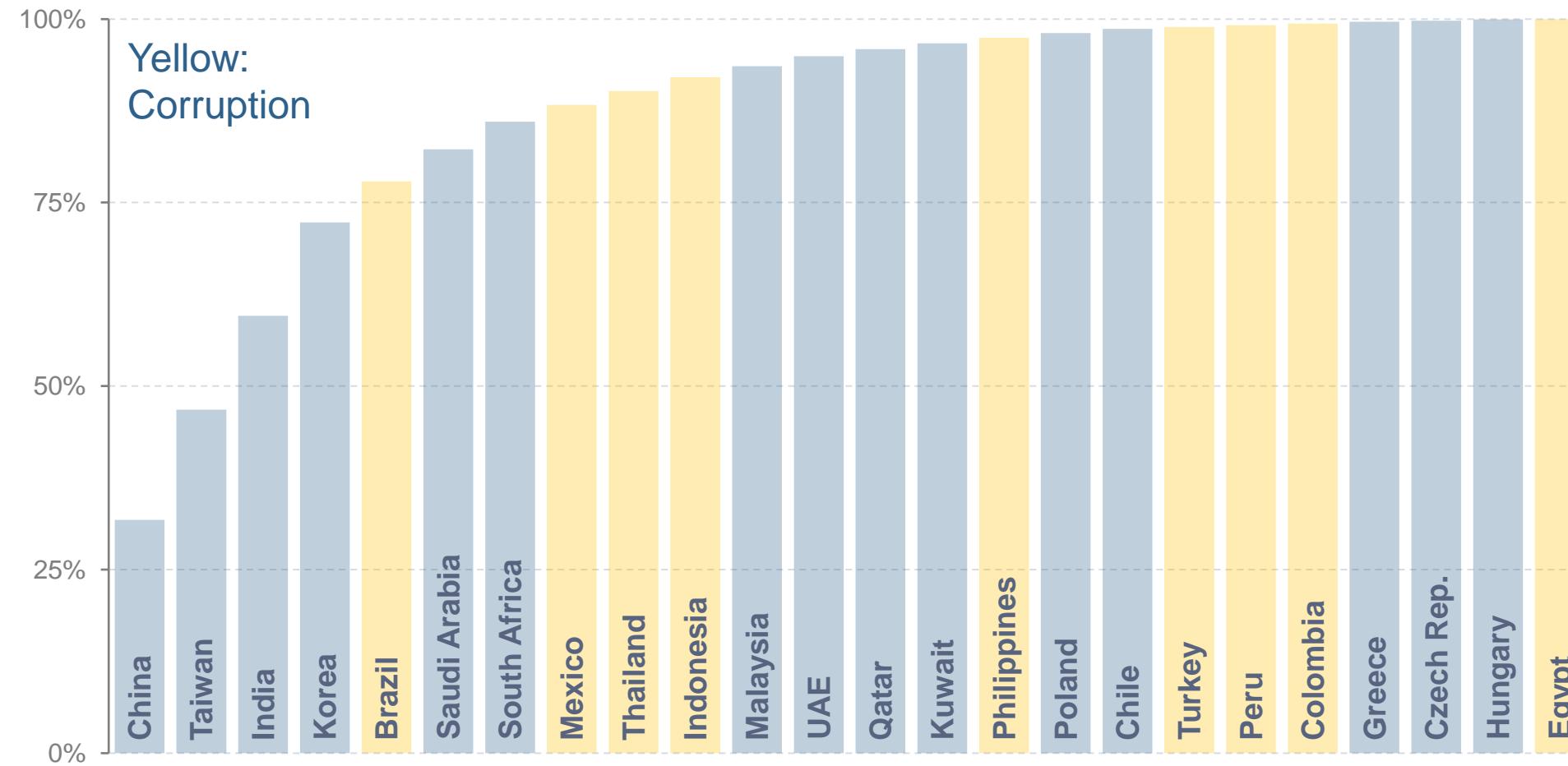


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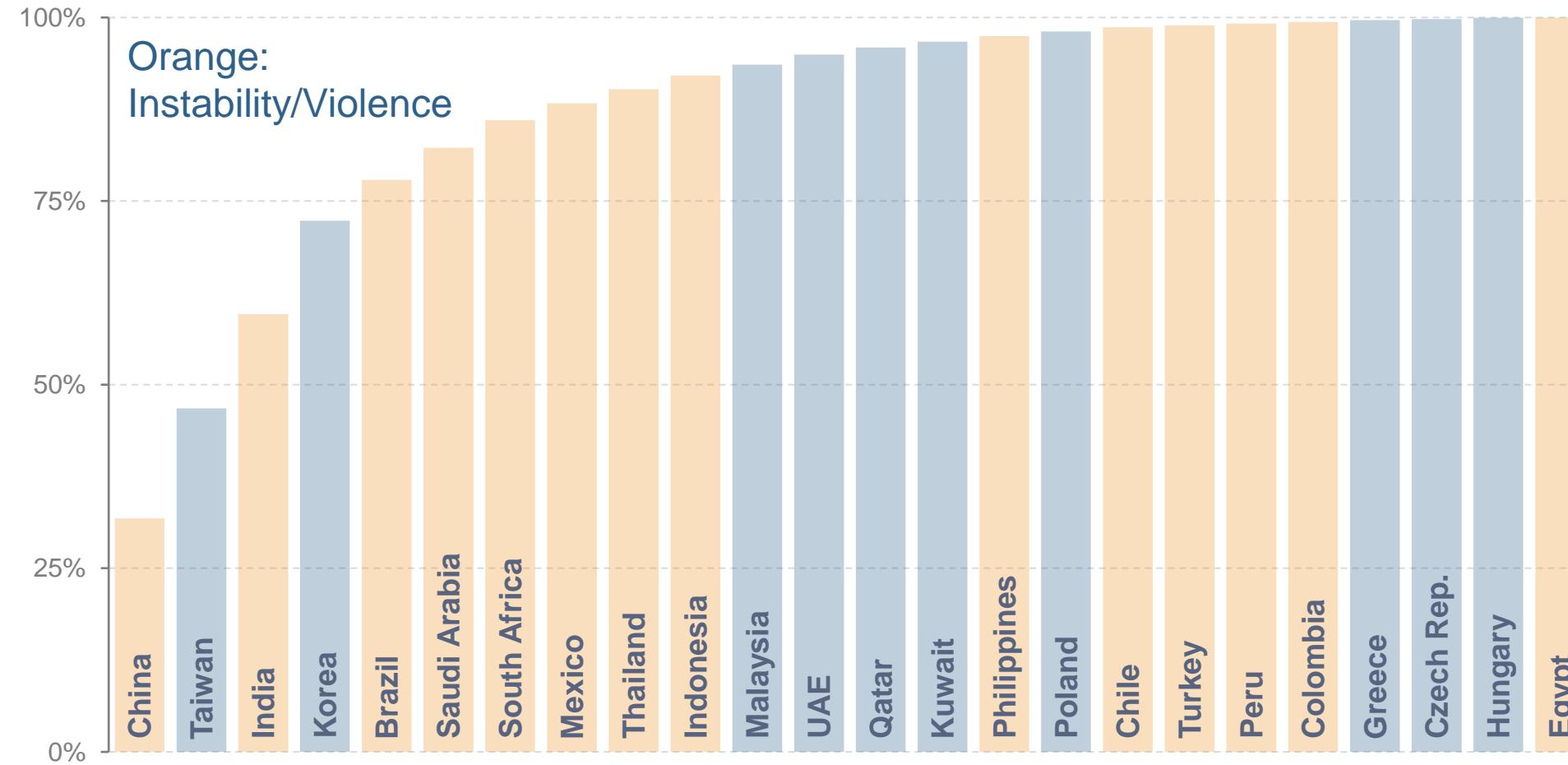
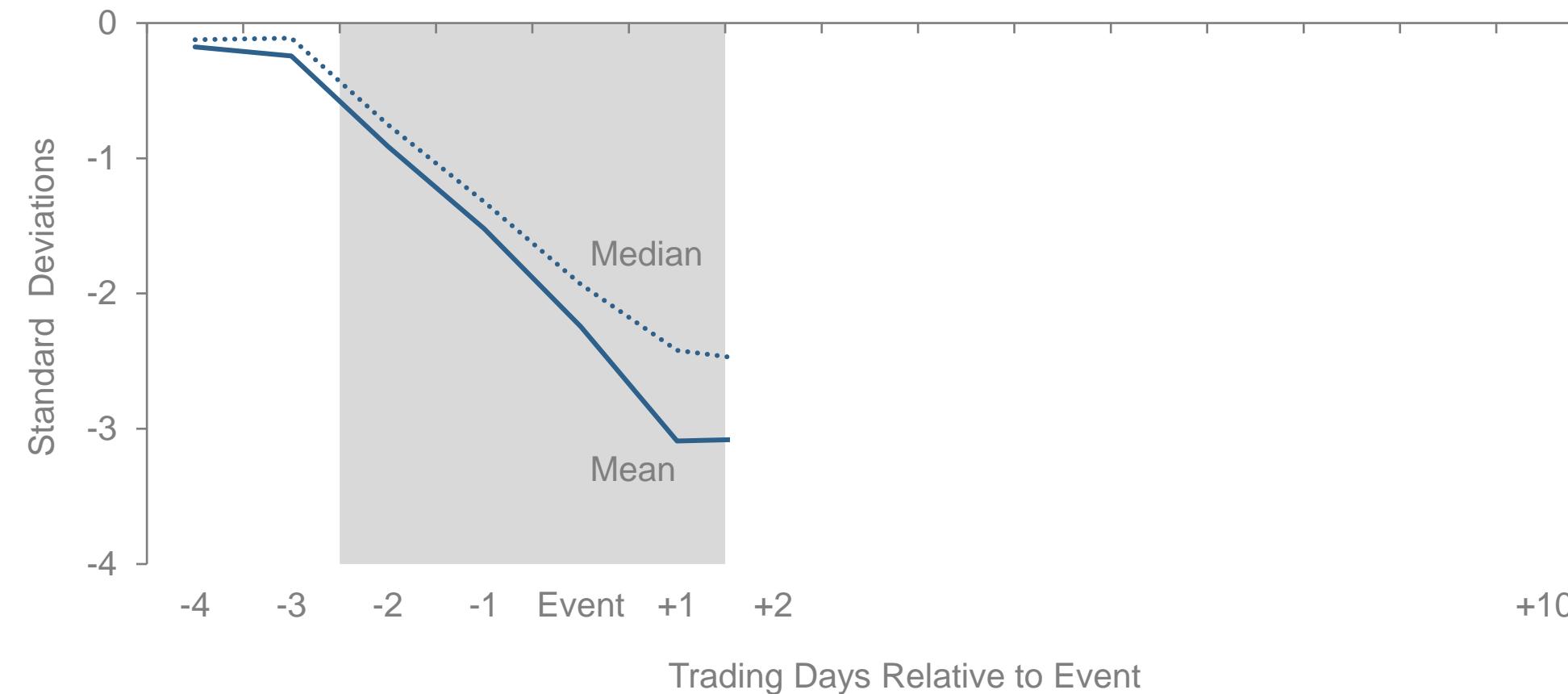


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# Markets' Response to “High Severity” Geopolitical Shocks

PROPRIETARY DATASET: WORST 30% OF OBSERVATIONS IN EVENT WINDOW

CUMULATIVE ABNORMAL EXCESS RETURNS (STANDARDIZED VS. CONTROL WINDOW)



Local market returns (in USD) starting four trading days prior to an event. Standardized abnormal returns are daily returns less the market's prior 120-day average return and divided by its prior 120-day volatility. Date Range: 1931-2015. Ex-post high-severity events are defined as those having cumulative losses during the event window ( $t-2$  through  $t+1$ ) in the worst 30% of the sample. Results reflect filtering of events with overlapping windows. Sources: Acadian Asset Management LLC, Global Financial Data and publicly available blogs and wikis. Returns are of the major local exchanges where each event occurred. It is not possible to invest directly in any index. Past results are not indicative of future results. Every investment program has an opportunity for loss as well as profits.

- ▶ Geopolitical event risk: Prevalence in EM puts a premium on its management
- ▶ Don't panic; prepare
- ▶ Best practices:
  - Diversify
  - Incorporate geo risk into the alpha model
  - Don't rely solely on backwards-looking risk management



## Takeaways

- Deglobalization: Possible, but evidence suggests otherwise
- EM benchmarks: Recognize that they're active
- Geopolitical event risk: Prepare; don't panic

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