GLOBAL EMERGING MARKETS

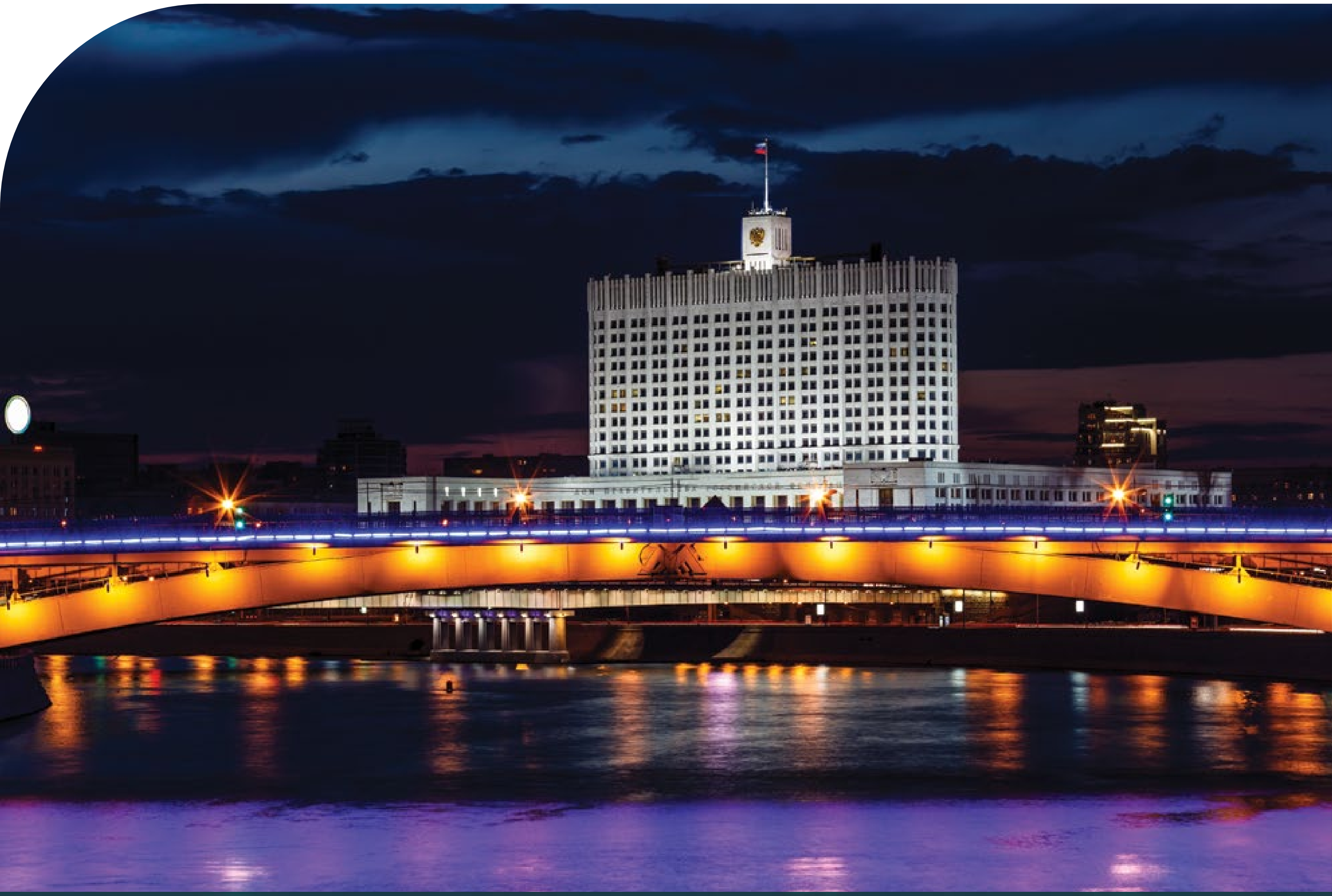
MARTIN CURRIE

FEBRUARY 2022

For institutional, professional and wholesale investors only

RUSSIA: GEOPOLITICAL RISK REACHES CRISIS POINT

As geopolitical tension mounts around Russia and Ukraine, our Global Emerging Markets team shares some insights into what is happening, the risks and what it means for the portfolio.



What risk does the current situation pose?

The build-up of Russian troops along the Ukrainian border has been a growing source of tension in recent months. With the entry of Russian troops into eastern Ukraine this week, the threat to Ukraine's sovereignty has reached crisis point and this has led to extreme levels of volatility in Russian stocks. Our Global Emerging Markets team anticipates that Russia may seek to occupy the Donetsk and Luhansk regions of Ukraine and that this in turn will trigger a wave of sanctions against Russia from foreign governments.

There are several sanctions which have been tabled as a possible response to the current crisis. These range from those directed at government-linked businesses or individuals through to broad-based restrictions limiting Russia's international economic ties. Sanctions of increasing severity are likely to be rolled out in response to any escalation of infringements against Ukraine's sovereign rights.

> Despite its geopolitical challenges, Russia is home to some highly profitable and well managed businesses which, in light of the ever-present political risks, trade at much lower valuations than their global peers.

What does this mean for the portfolio?

Russia represents a small but highly conspicuous part of the emerging markets universe. As an investment opportunity it is driven by political risk, given that the country's stock market is dominated by state-owned national champions such as Gazprom, Rosneft and Sberbank. The politicised nature of the Russian market is exacerbated by the fact that much of Russia's political ideology is at odds with that of the US, UK and EU. Within our Global Emerging Markets strategy we seek to allocate portfolio risk to stock specific factors rather than to macro-related factors. Macroeconomic and other top-down factors are viewed as a source of risk to our strategy, rather than as a source of alpha.

Since 2014, following Russia's annexation of the Crimea, we have maintained our Russian exposure at close to its country weight in the MSCI Emerging Markets Index. We have not been prepared to take more risk given the unpredictable nature of Russian geopolitical risk. Despite its geopolitical challenges, Russia is home to some highly profitable and well managed businesses which, in light of the ever-present political risks, trade at much lower valuations than their global peers.

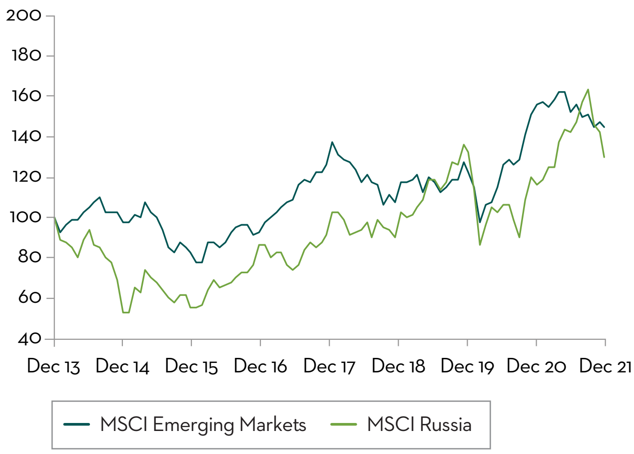
Consider the performance dispersion for MSCI Russia compared to the MSCI Emerging Markets Index since 2014, when Russia invaded the Crimea (graph shown overleaf): the dispersion on an absolute basis has averaged 35% per annum[1]. Over the same period, the standard deviation of monthly returns for the MSCI Russia Index is almost double the MSCI Emerging Markets Index at 7.8% (versus 4.7% for the latter)[2]. This marked a turning point for Russian equities in terms of market volatility.

The information provided should not be considered a recommendation to purchase or sell any particular strategy/fund/security. It should not be assumed that any of the security transactions discussed here were or will prove to be profitable.

[1]Dispersion calculated as the arithmetic average of the absolute difference in annualised performance 2014-2021 for MSCI Russia and MSCI Emerging Markets, As at January 2022. Source: MSCI.

[2]Standard deviation is calculated on the index monthly returns from 1 January 2014 to 31 January 2022. Source: MSCI.

Index performance of MSCI Russia compared to MSCI Emerging Markets



Source: MSCI to 31 January 2022. Index performance rebased to 100 from a start date of 31 December 2013.

We have taken a cautious approach to the Russia-Ukraine situation by limiting our overall exposure to the region. As of 31 January 2022, we are underweight Russia with 2.7% weight in the strategy's representative account, compared to the benchmark at 3.3%. We sold one Russian stock in early January to remove any direct state link from our investments. We view state-linked businesses in Russia as being at greatest risk of equity market sanctions.

We continue to own two private sector companies in Russia, Lukoil and TCS Group. We retained energy exposure, via Lukoil, to participate in the high oil price/low ruble environment that would likely follow the conclusion of the current situation. Our positioning in both companies is intentionally private sector to avoid exposure to state-directed sanctions.

We are ensuring that our overall exposure to Russian geopolitics is carefully managed whilst staying invested in standout companies. Currently, international sanctions are imposed on individuals linked to President Putin or the Russian government, as well as a ban on long-term international financing for Russian companies. The main sanction risk remaining to our positions would be an outright ban on owning Russian equities. We have an underweight exposure to this risk due to our underweight country exposure relative to the index. Our TCS position is also Cyprus-based/Russia exposed, so may not be impacted if sanctions are applied specifically to Russian registered companies.

In terms of Ukraine, we have risk exposure through our investment in EPAM, a US-listed IT Services company with approximately 50% of its staff based in Ukraine, Russia and Belarus. The company has strong contingency plans to ensure continuity of service and we are comfortable that these would be effective in all but the most extreme circumstances. EPAM is not expected to be impacted by any sanctions and, while it may be impacted by event-related sentiment, there is no material, long-term threat to its business.

Despite the extensive available commentary, it is very difficult to predict how the current crisis will evolve. We are invested in excellent companies for the long term that offer very attractive risk-reward profiles and our portfolio has maintained a measured exposure to Russia and Ukraine. We believe this is the prudent approach to take as long-term equity investors and with the unpredictability of the geopolitical landscape, especially in countries like Russia.

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Portfolio weights are for the Global Emerging Markets representative account, as at 31 January 2022. Benchmark index used is the MSCI Emerging Markets Index.

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