



# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

Arjun Divecha

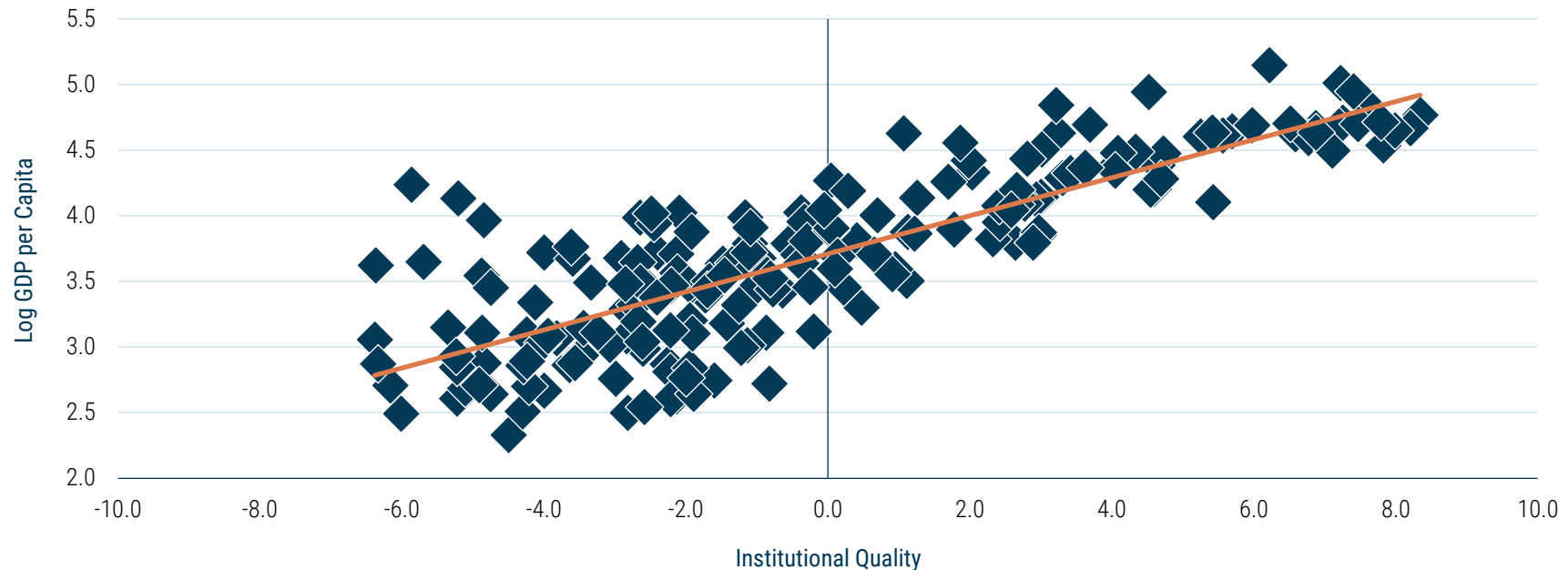
April 2019

 **Why are rich countries rich and poor countries poor?**

# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

*Why are rich countries rich and poor countries poor?*

AVERAGE QOI 2004-2005 VS. WEALTH, ALL COUNTRIES



***Not surprisingly, there's a very strong relationship  
between quality of institutions (QOI) and wealth***

Source: World Bank, GMO




Why are rich countries rich and poor countries poor?

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*In short, don't fall in love, but date...*

*...promiscuously*

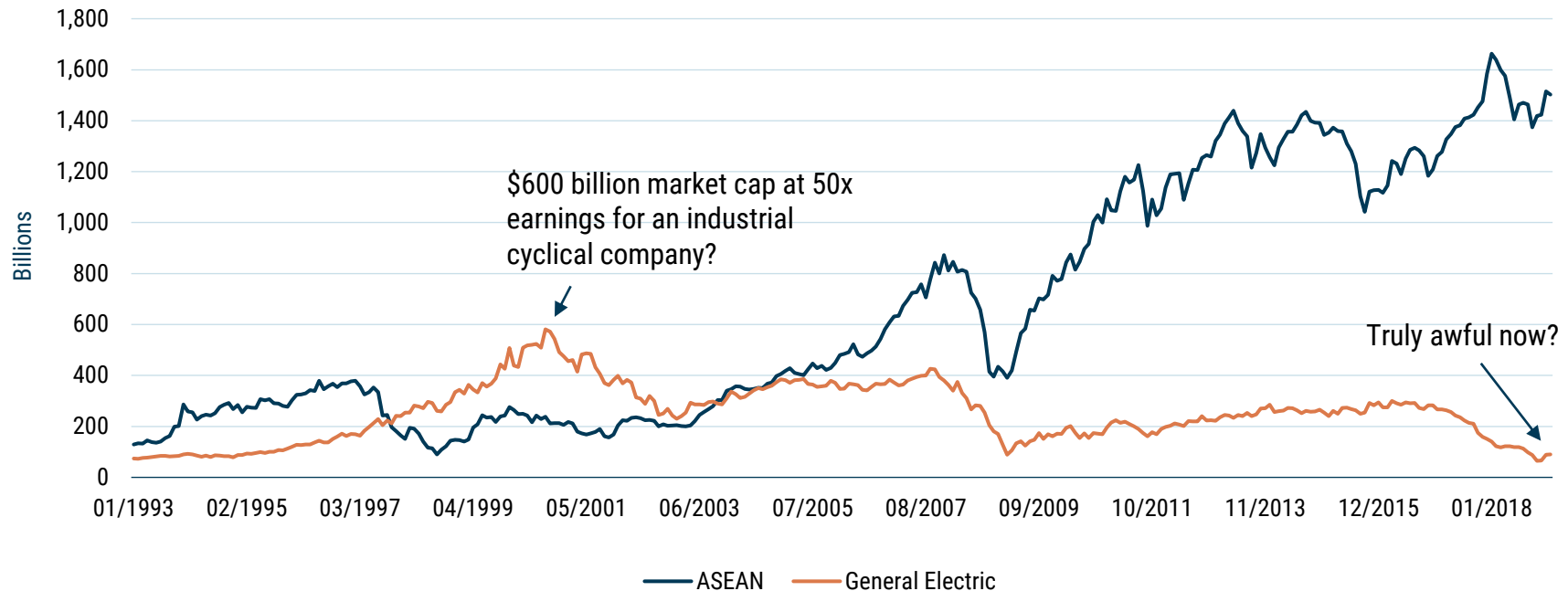


**You make more money when things go from truly awful to merely bad than when things go from good to great.**

# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

*You make more money when things go from truly awful to merely bad than when things go from good to great*

MARKET CAP OF GE VS. ASEAN\*



As of 9/30/18

\* Indonesia, Malaysia, Singapore, Thailand, Philippines

The security identified above is for illustrative purposes only. The specific security was not selected on the basis of its investment performance. Securities identified are not necessarily representative of the securities purchased, sold, or recommended for advisory clients, and it should not be assumed that an investment in the security identified will be profitable.



When the government decides to screw you...

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*...you are screwed...*

 When the government decides to screw you...

*...you are screwed...*

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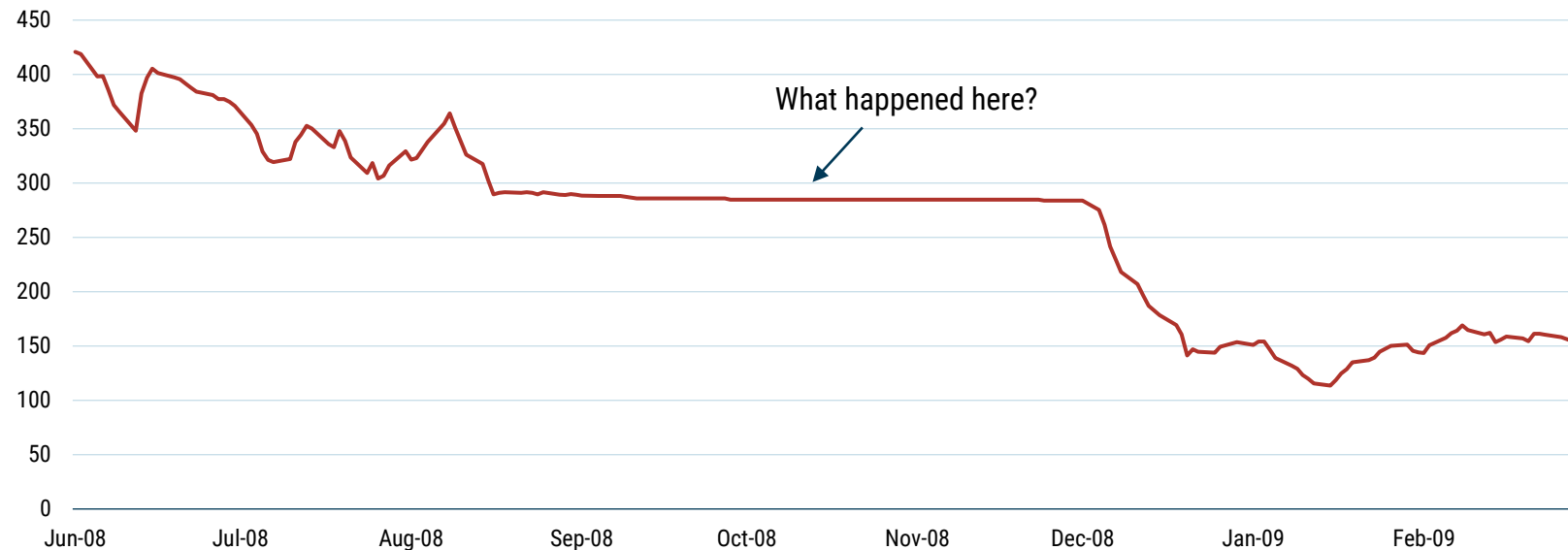
*...because they can (and will) change the rules on you.*



# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

*When the government decides to screw you...*

## MSCI PAKISTAN INDEX



As of 3/11/09 | Source: MSCI, Bloomberg

# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

*When the government decides to screw you...*

BUSINESS

## How Narendra Modi's political priorities ambushed Amazon and Walmart, and benefited India's richest man

BLOOMBERG

**MUMBAI** - Amazon Inc. and Walmart Inc.'s plans to dominate India's online retail landscape have been ambushed by Prime Minister Narendra Modi's political priorities heading into a tightening election.

The vote, which must be held by May, has increased the influence of local retailers that lobbied for growth-crimping curbs on the U.S. giants. On cue, India this month rolled out constraints on foreign e-commerce players, including Jeff Bezos-led Amazon and Walmart-owned Flipkart, which together control 70 percent of its online shopping.

The tighter rules, aimed at protecting small traders, may end up benefiting the country's richest man, Mukesh Ambani, who is building a homegrown competitor.

Modi's Bharatiya Janata Party is still licking its wounds after being trounced in three key recent state polls and a year ago fighting an unexpectedly close contest in Gujarat — Modi's home state. Among small businesses, which are a traditional support base, the government's popularity has been eroded by 2016's surprise cash ban and the subsequent chaotic rollout of a new sales tax.

The rules now bar Amazon and Flipkart Online Services PTE from owning inventory and require them to treat all vendors equally, throttling discounts and exclusives — a huge advantage to homegrown companies, including Ambani's new venture. His Reliance Industries Ltd., which owns India's largest retail chain and third-biggest telecommunications network, has the potential to evolve into a local version of Amazon or Alibaba Group Holding Ltd., UBS AG said last month.

FEB 5, 2019

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KEYWORDS

INDIA, AMAZON, NARENDRA

# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

NEW

Source:  
SEC

## ■ When the government decides to screw you...



### **SEC Halts Short Selling of Financial Stocks to Protect Investors and Markets**

**Commission Also Takes Steps to Increase Market Transparency and  
Liquidity**

**FOR IMMEDIATE RELEASE  
2008-211**

*Washington, D.C., Sept. 19, 2008* — The Securities and Exchange Commission, acting in concert with the U.K. Financial Services Authority, took temporary emergency action to prohibit short selling in financial companies to protect the integrity and quality of the securities market and strengthen investor confidence. The U.K. FSA took similar action yesterday.



Just as there are no atheists in foxholes, we've learned that there are no libertarians in financial crises.

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*Fama: "I would've favored nationalizing the banks, not bailing them out."*

*NY Times: "Really? that's not very libertarian, is it?"*

*Fama: "Well, we're talking about realistic alternatives. It's not credible that in a financial crisis, the government will do nothing."*

From Sunday 27<sup>th</sup> 2013 *New York Times*, interview with Nobel prize winner (and "Extreme Libertarian") Eugene Fama



Getting the big picture right is the most important thing...

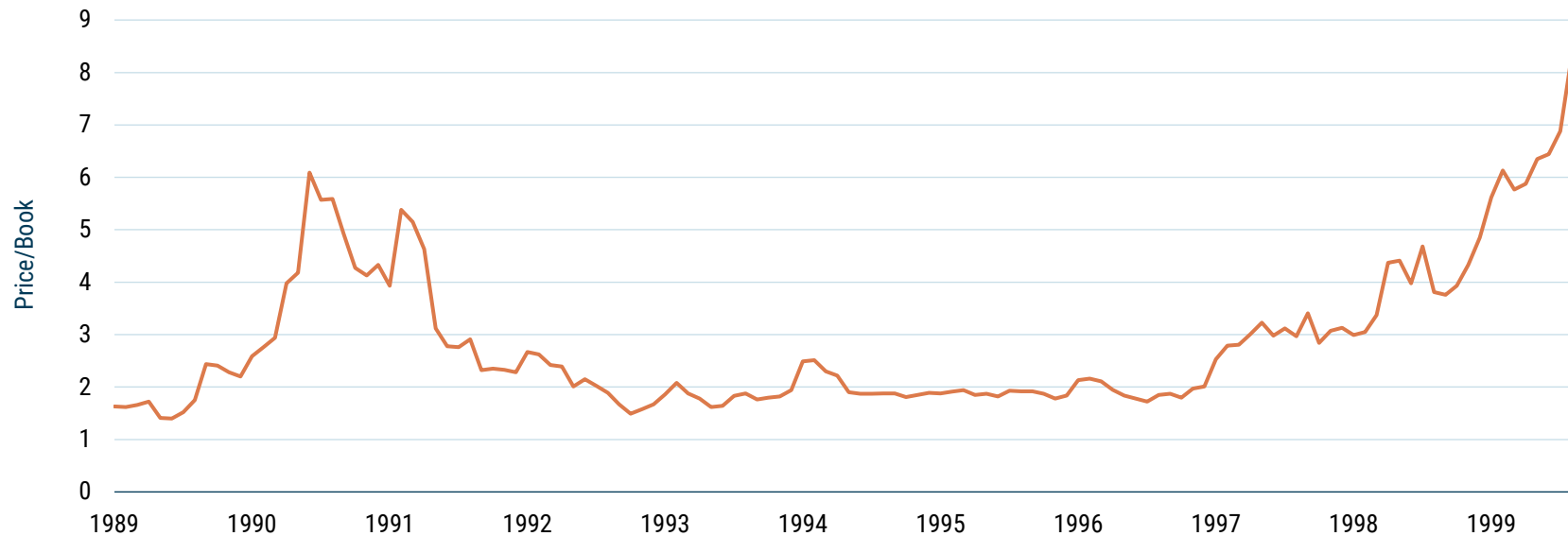
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***...being in the right countries and  
sectors matters the most.***

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*Getting the big picture right is the most important thing*

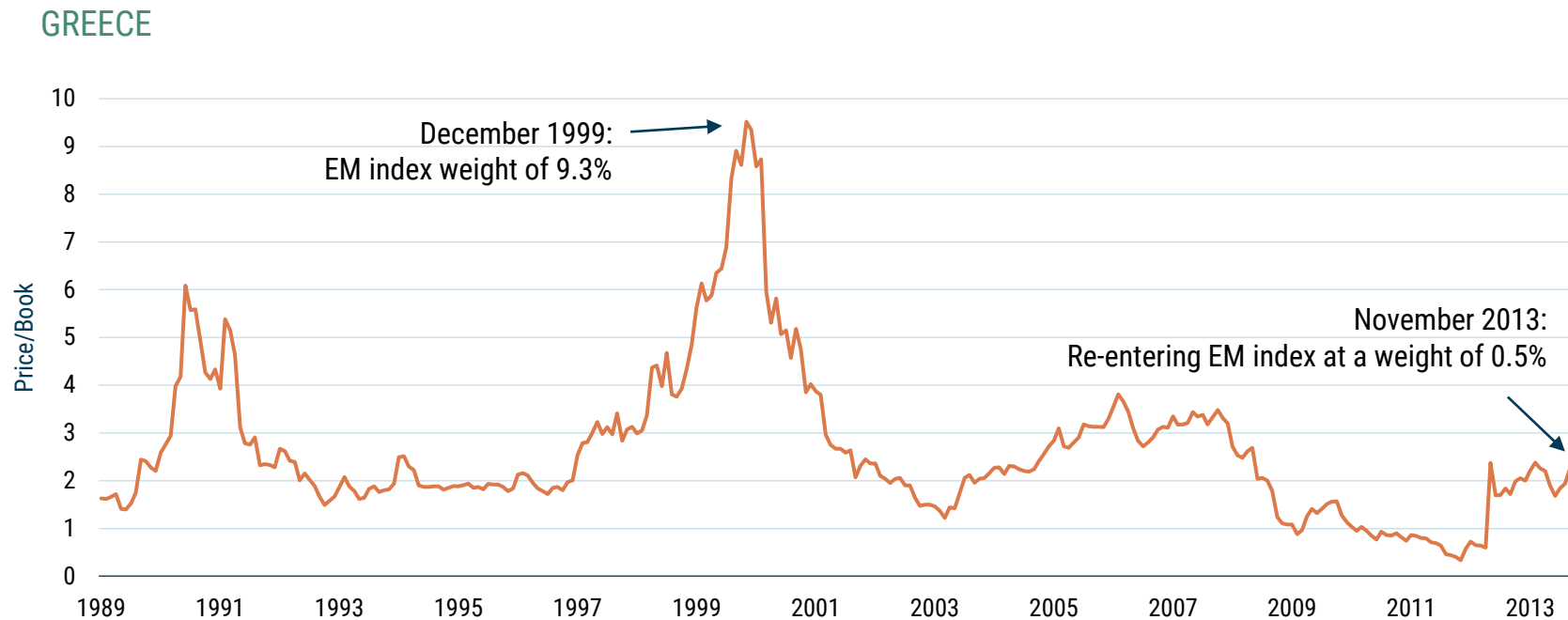
## CHRONICLE OF A DEATH FORETOLD: GREECE UNDERWEIGHT 10%



As of 9/30/99 | Source: MSCI, IFC, GMO

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*Getting the big picture right is the most important thing*



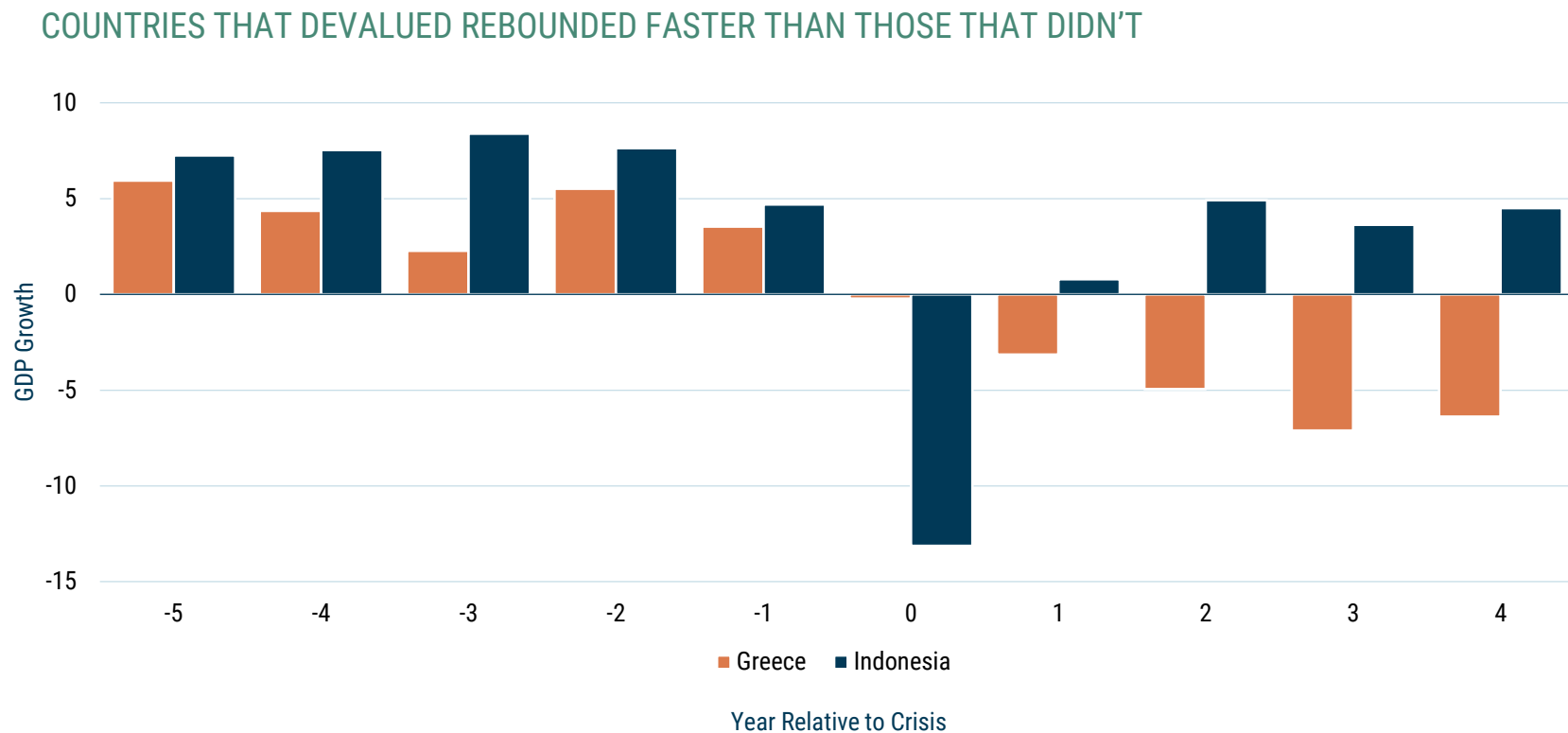
As of 9/30/13 | Source: MSCI, IFC, GMO

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*Devaluation beats austerity for both investors and citizens*



Source: World Bank

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# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

NEW

## ■ Devaluation beats austerity for both investors and citizens.



 **Beware the curse of creeping professionalism.**



Emotion is the enemy of successful investing.

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*This is the single biggest advantage  
quant has over fundamental investing.*




Data plus cleaning equals information.

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***If I could choose between everyone having dirty data and everyone having super clean data, I'd choose the former.***

***Every day.***



**Be wary of back-tests – the past is not always what it once was.**

# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

*Be wary of backtests – the past is not always what it once was*

<b>December 1993</b>	<b>What It Was Then (Wgt. %)</b>	<b>What They Now Say It Was (Wgt. %)</b>
Argentina	7.2	5.6
Brazil	11.8	6.9
Chile	1.7	1.2
China P.R.	0.0	0.4
Colombia	1.5	1.2
Greece	1.9	1.1
Hungary	0.0	0.1
India	2.7	2.0
Indonesia	2.2	1.7
Jordan	0.3	0.2
Korea Republic	2.6	1.7
Malaysia	23.4	18.0
Mexico	26.8	22.9
Pakistan	0.6	0.6
Peru	0.0	0.5
Philippines	2.4	2.5
Poland	0.0	0.3
Portugal	1.7	1.1
South Africa	0.0	21.6
Sri Lanka	0.0	0.1
Taiwan	1.7	1.6
Thailand	4.2	4.2
Turkey	6.6	4.2
Venezuela	0.7	0.4
Zimbabwe	0.0	0.0

Source: S&P/IFC

 **Use the illusion of precision to your advantage.**

 **How do you characterize a market that's fallen 90%?**





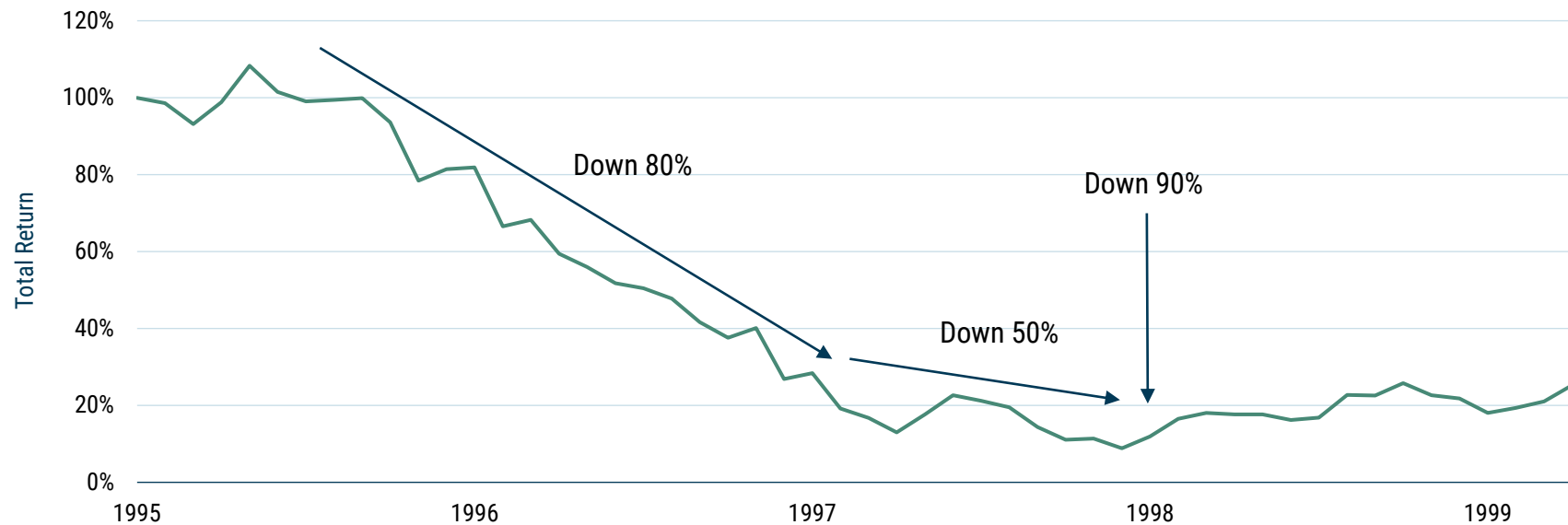
How do you characterize a market that's fallen 90%?

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*It's a market that first fell 80%...*

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THAI INDEX TOTAL RETURN DURING ASIA CRISIS




As of 12/31/99 | Source: S&P/IFC

➤ How do you characterize a market that's fallen 90%?

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*It's a market that first fell 80%...*

*...and then halved.*

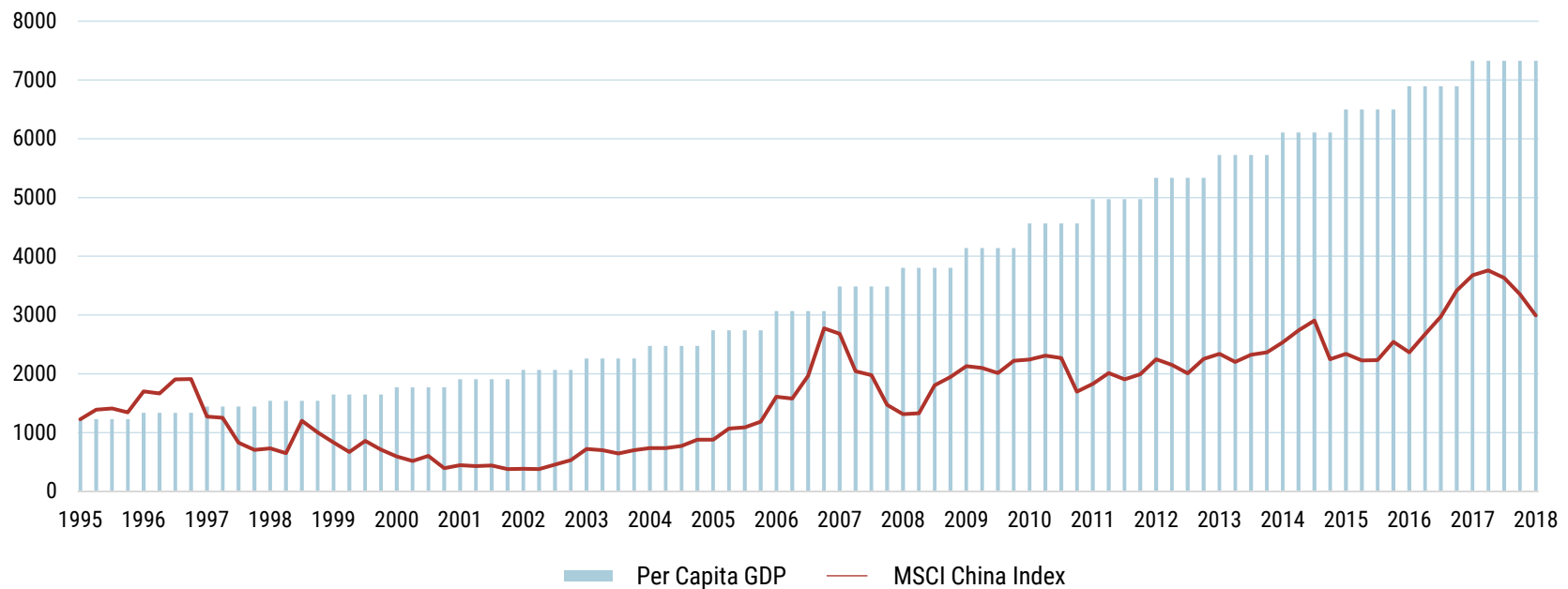


**The paradox of growth – you invest in emerging markets for their growth but you don't make money in the fast-growing places.**

# INSIGHTS ON LIFE, INVESTING, AND EMERGING MARKETS

*The paradox of growth – you invest in emerging markets for their growth but you don't make money in the fast-growing places*

CHINA PER CAPITA GDP VS. STOCK MARKET RETURN (MSCI CHINA INDEX)

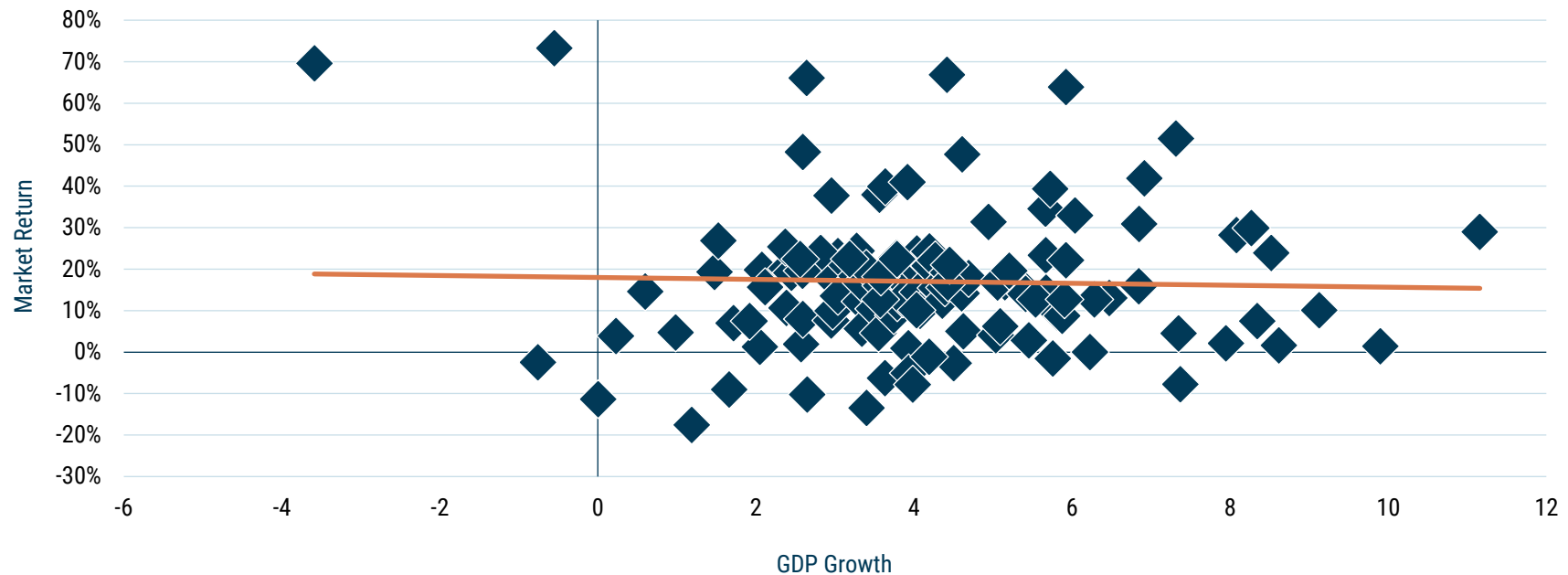


As of 12/31/18 | World Bank, MSCI

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*The paradox of growth – you invest in emerging markets for their growth but you don't make money in the fast-growing places*

ALL EMERGING MARKETS, ALL 5-YEAR PERIODS 1985-2012 (NON-OVERLAPPING)



As of 8/31/12 | S&P/IFC, World Bank, GMO

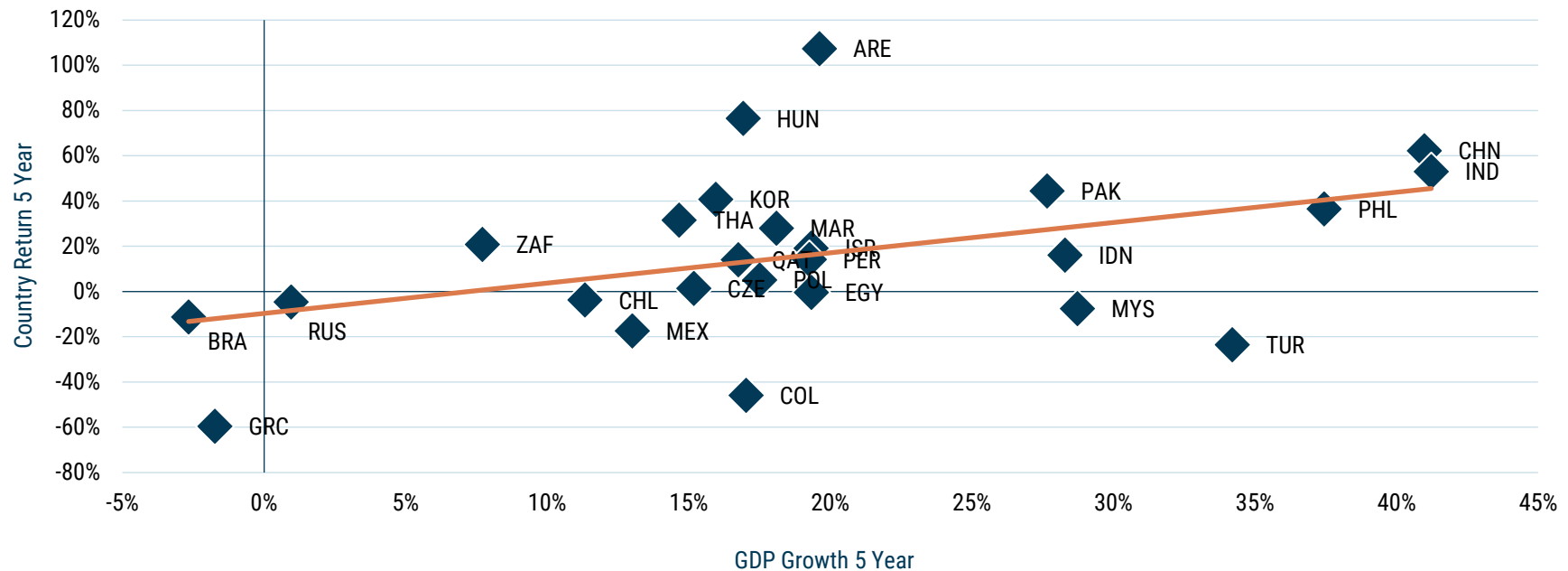
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*Update: During the past 5 years there has been a slight positive relationship between GDP Growth and Stock Market Return, mainly because of India and China*

GDP GROWTH VS. STOCK MARKET RETURN 2013-2017



As of 2017 | World Bank, MSCI

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*The paradox of growth – you invest in emerging markets for their growth but you don't make money in the fast-growing places...you make money in the cheapest places*

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## ***Average Annualized \$U.S. Return, 2008-2018\****

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Most Expensive Countries	14.9%
Cheapest Countries	19.9%

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**Source: GMO**

\* Portfolio formed of 1/3 countries each month and held for 5 years



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- On the other hand, it's not always a mistake to pay up for growth.
  - It's only mostly a mistake...
- When Microsoft went public in 1986, I didn't buy it because it was trading at 20 times earnings (vs 14x for the S&P500). If I had bought and held it till today it would have delivered 25% annually vs 8.75% for the S&P 500.
- Alibaba went public at 50 times earnings in Sept 2014. If you bought it a day after the IPO and held it till today you'd have made 90% on your money...

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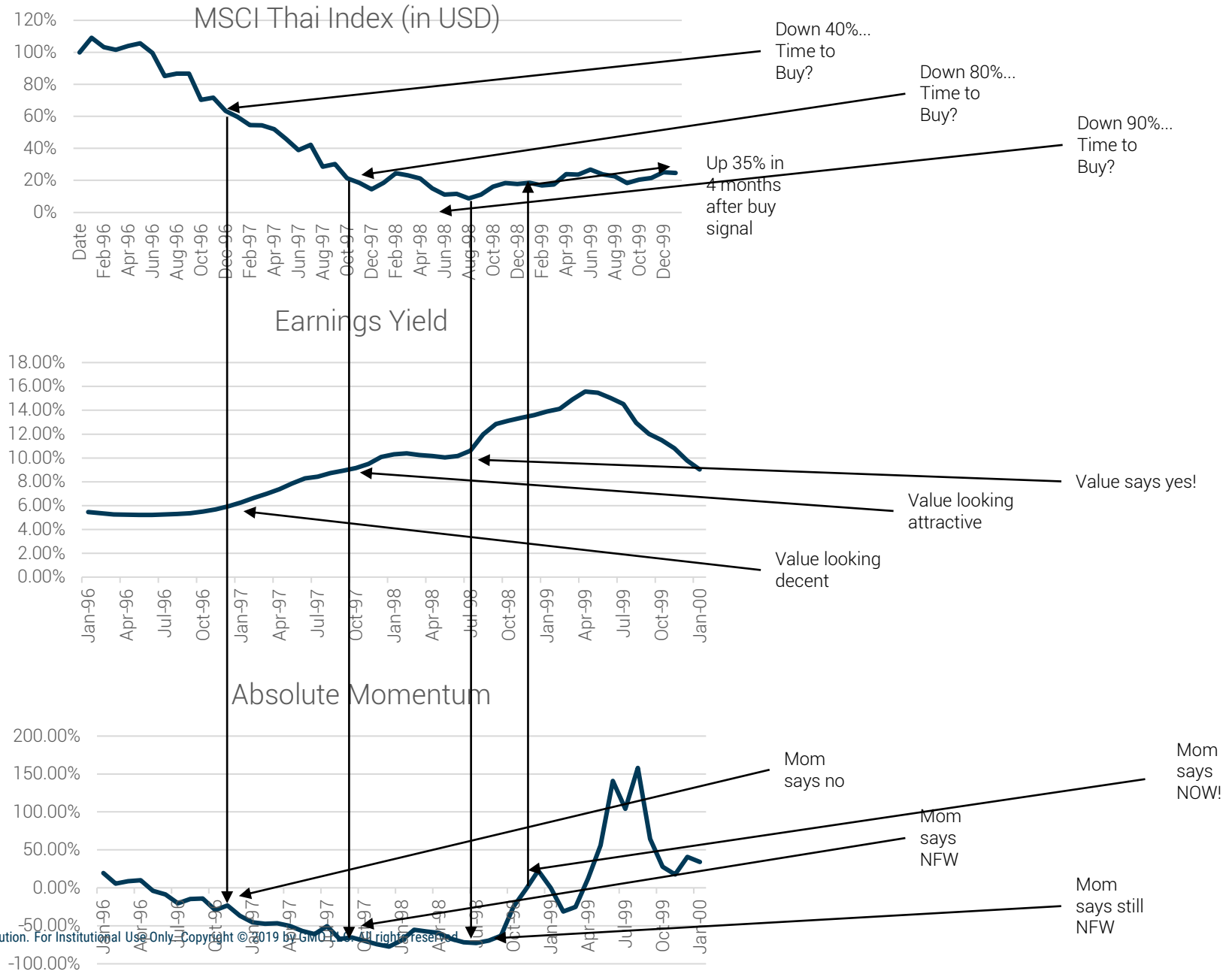
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- Not everything that is cheap is Value. Some of it is Junk. And yes, you do occasionally make money buying Junk (Q2 2009\*), but not in the long run.
- There are two problems with buying Value:
  - You get caught in value traps
  - You get in and out too early
- Combining value with quality and momentum sets guardrails that help avoid these problems.

\* Russell 200 Index was up 113% in Q2 2009

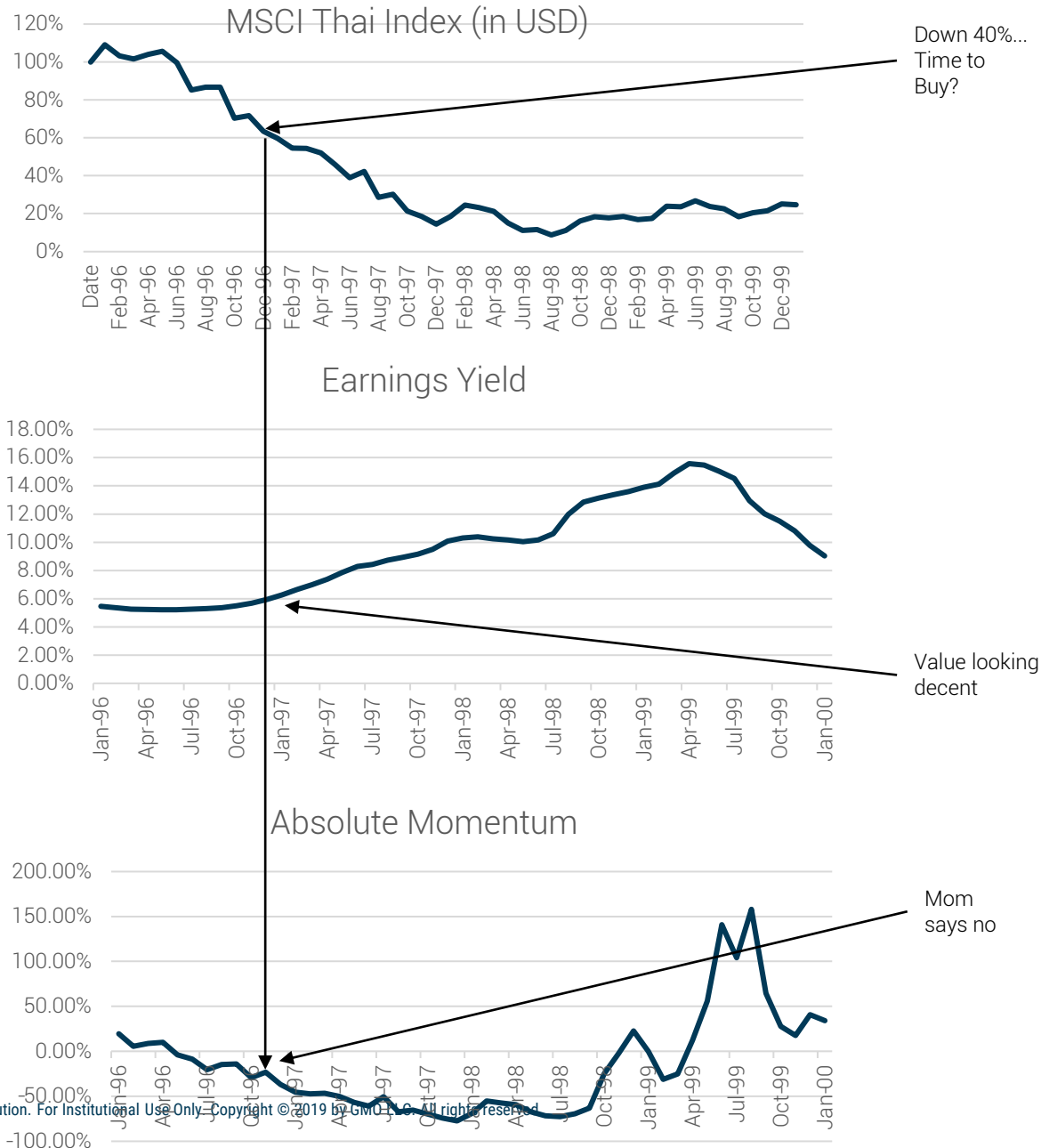
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MASTER for next  
few slides – This  
slide is not used

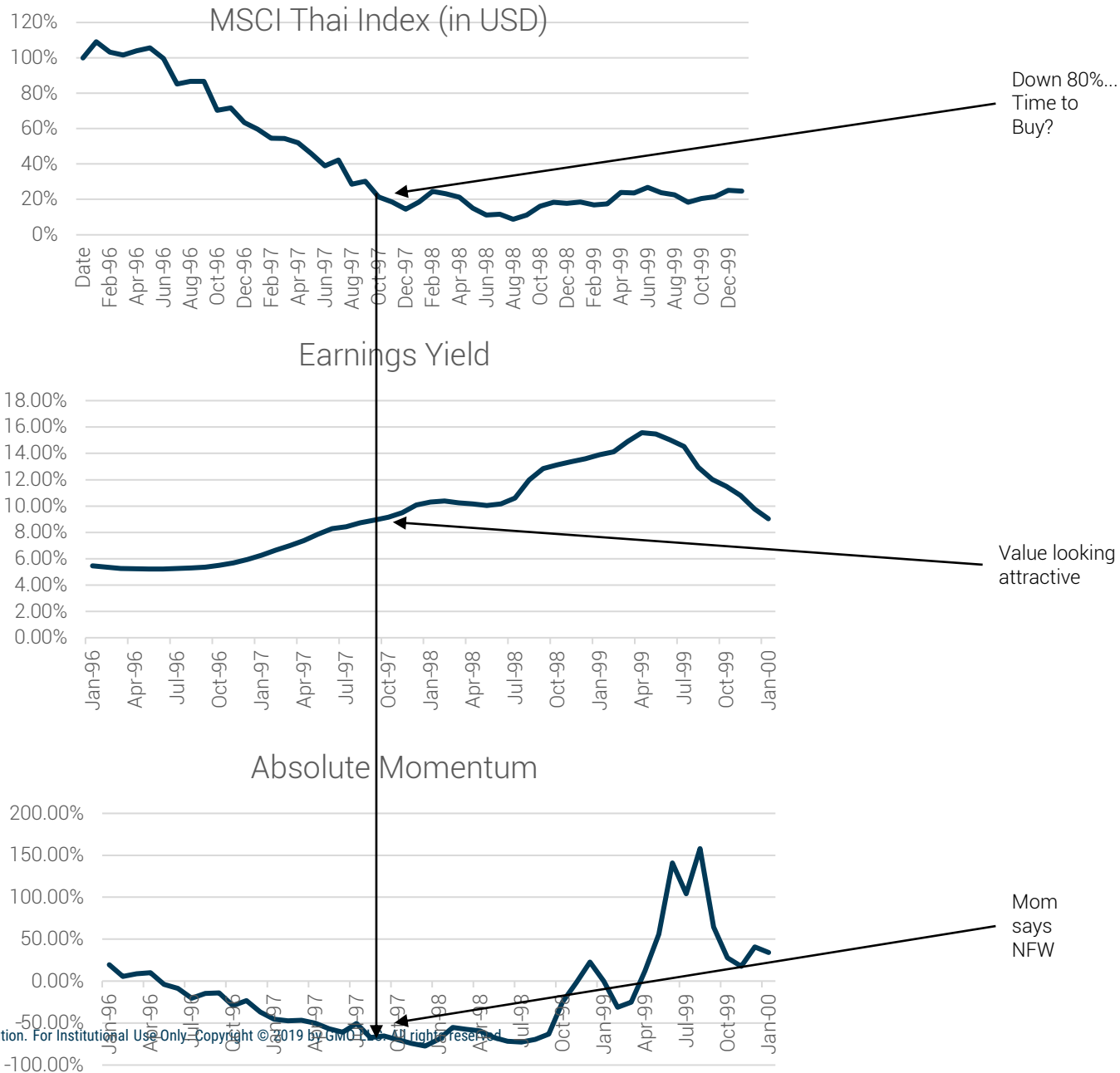


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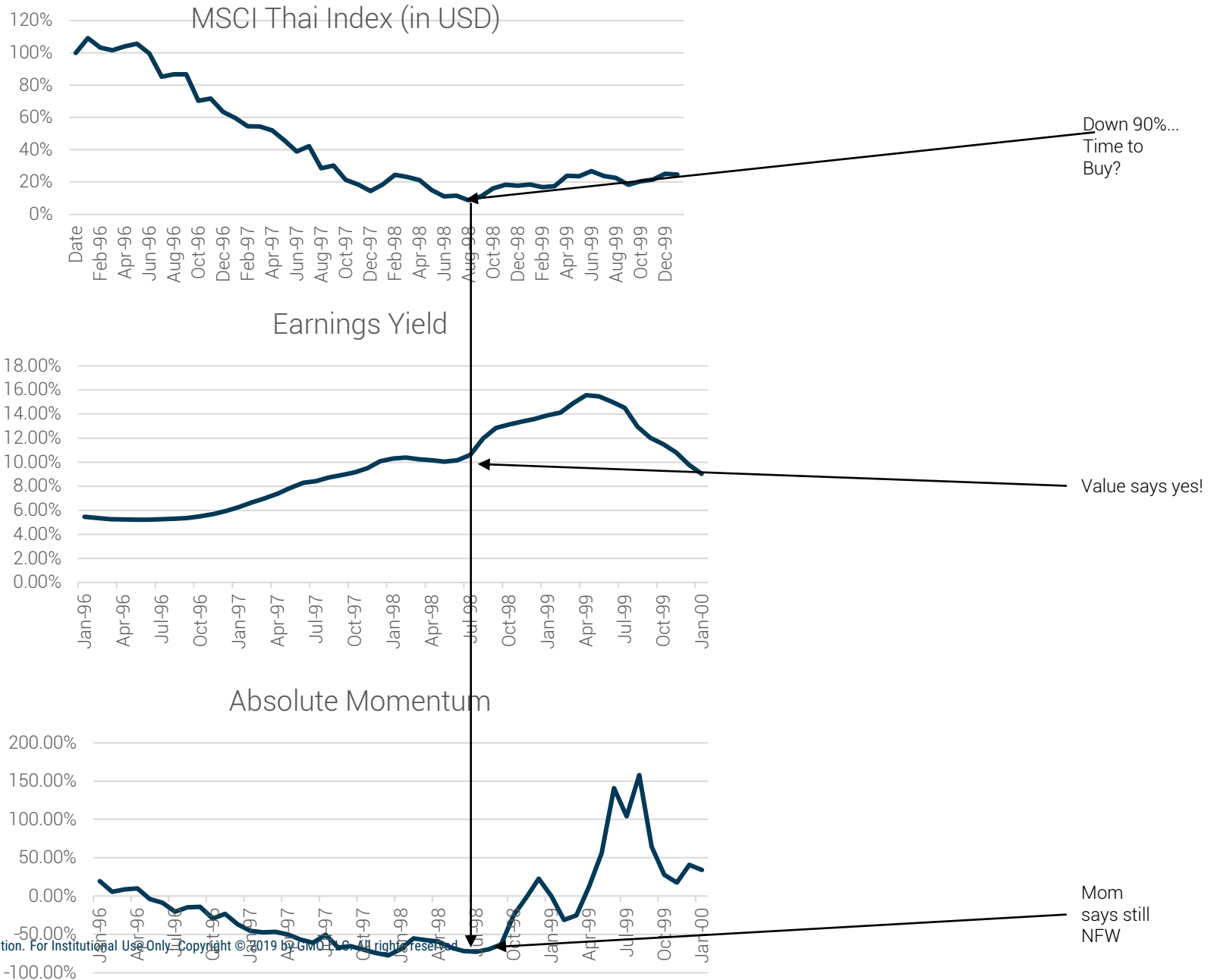
Source: GMO,  
MSCI,  
Bloomberg



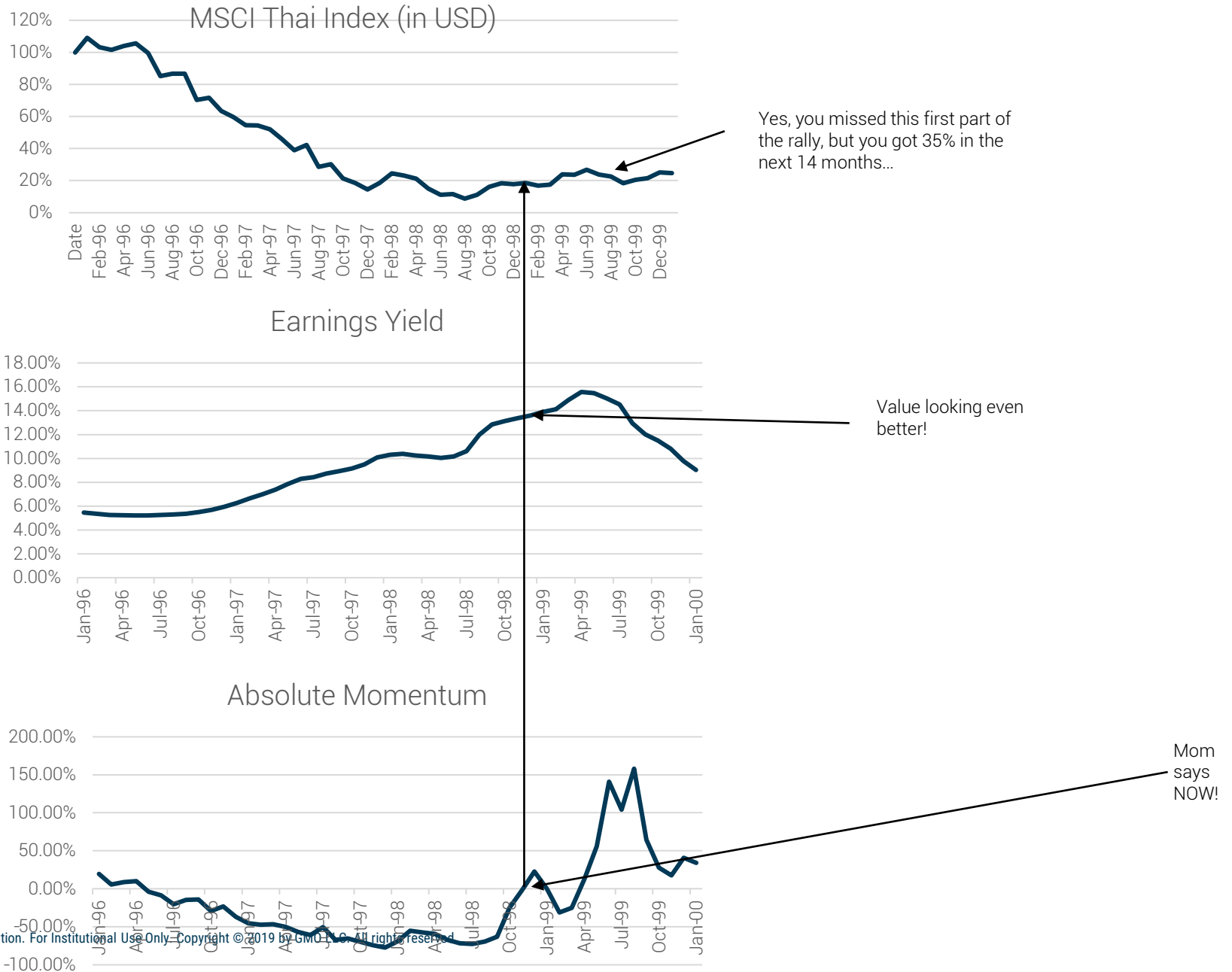
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New

- Conclusion – Momentum can keep you out of serious trouble and when Value AND Momentum agree, it's when you want to have your biggest position in place



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- Final thoughts:
  - Career risk is a major driver of investment cycles.
  - As a long term value investors we (GMO) may arrive, but not necessarily with the same passengers.

***“A few good ideas, ruthlessly executed”***

*– Jeremy Grantham*