Emerging Markets: Glass Half Full

Capture the Growth Opportunity

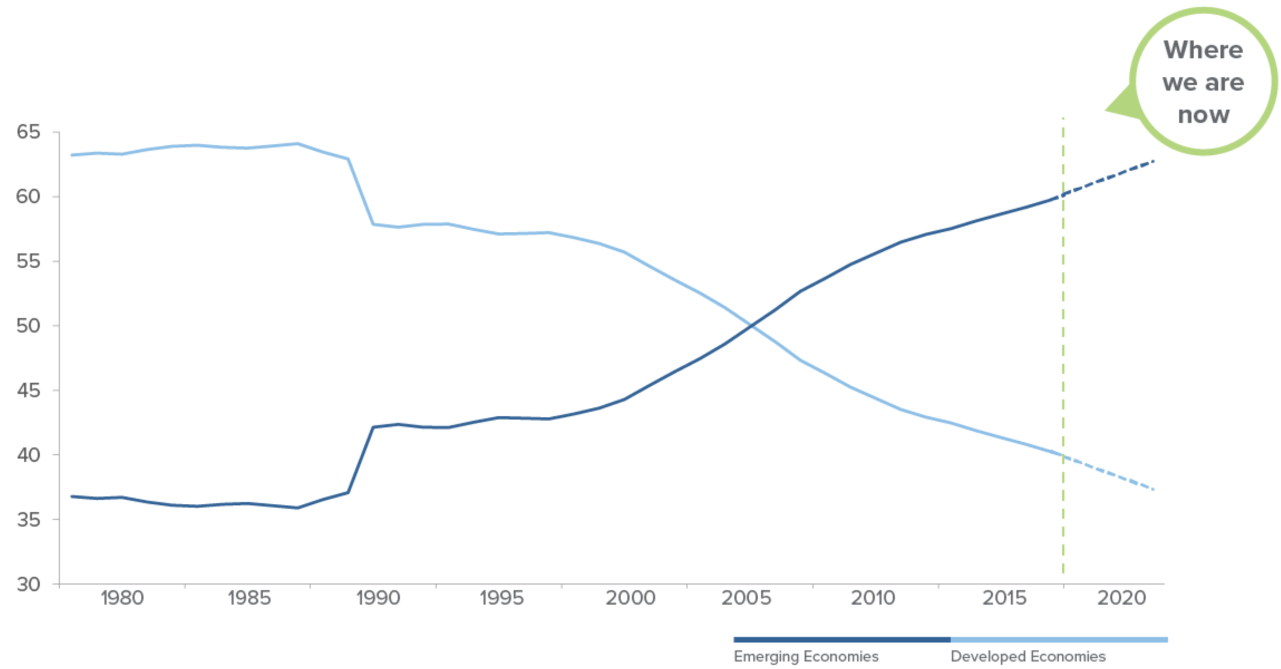
To ignore Emerging Markets is to miss out.

Patricia Perez-Coutts
Lead Portfolio Manager for Westwood Emerging Markets

Emerging Markets – Driving Global Growth

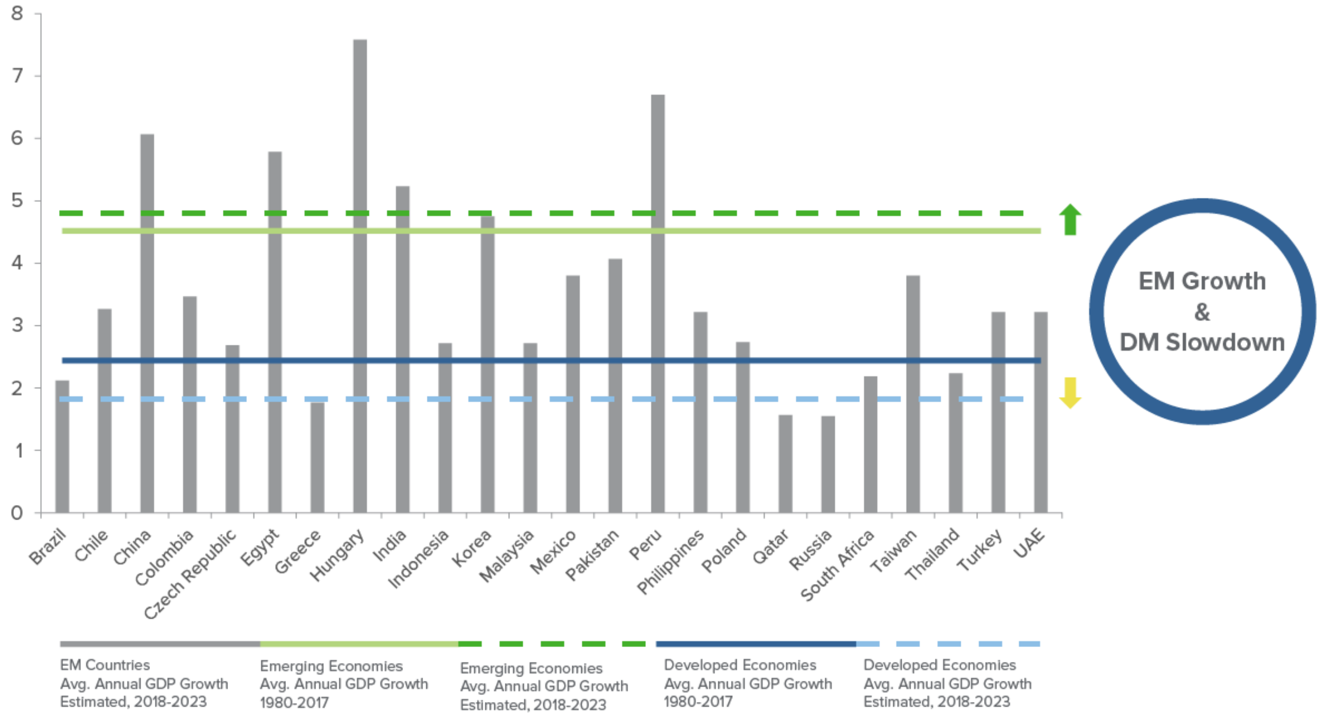
Emerging Markets (EM) is now 60 percent of the world's GDP and more than half of new consumption over the past 15 years, with forecasts indicating 63 percent by 2023. EM economies are projected to grow at a robust 4.8 percent for the next 5 years, even more than the annual historical average at around 4.5 percent. The real significance of EM growth is shown by comparing EM to Developed Markets (DM). While EM growth is still going strong, Developed Markets (DM) are projected to see a significant slowdown in growth. The projected GDP growth of DM economies is 1.8% for the next 5 years, considerably less than the 2.4% they have averaged historically. This is roughly 25 percent less growth for DM compared to the positive projected growth of EM economies. For investors looking forward to 2019 and beyond, growth opportunities across all market caps within Emerging Markets present compelling investment cases. We have recently seen Wall Street begin to anticipate the growth opportunity with Morgan Stanley recently double-upgrading emerging market equities to overweight from underweight while downgrading U.S. equities.

Emerging Markets vs Developed Markets – Percent of Global GDP



Source: IMF,GDP based on Purchasing Power Parity (PPP), October 2018

Emerging Markets & Developed Markets Real GDP Growth (2018-2023)



Source: Data from IMF, October 2018

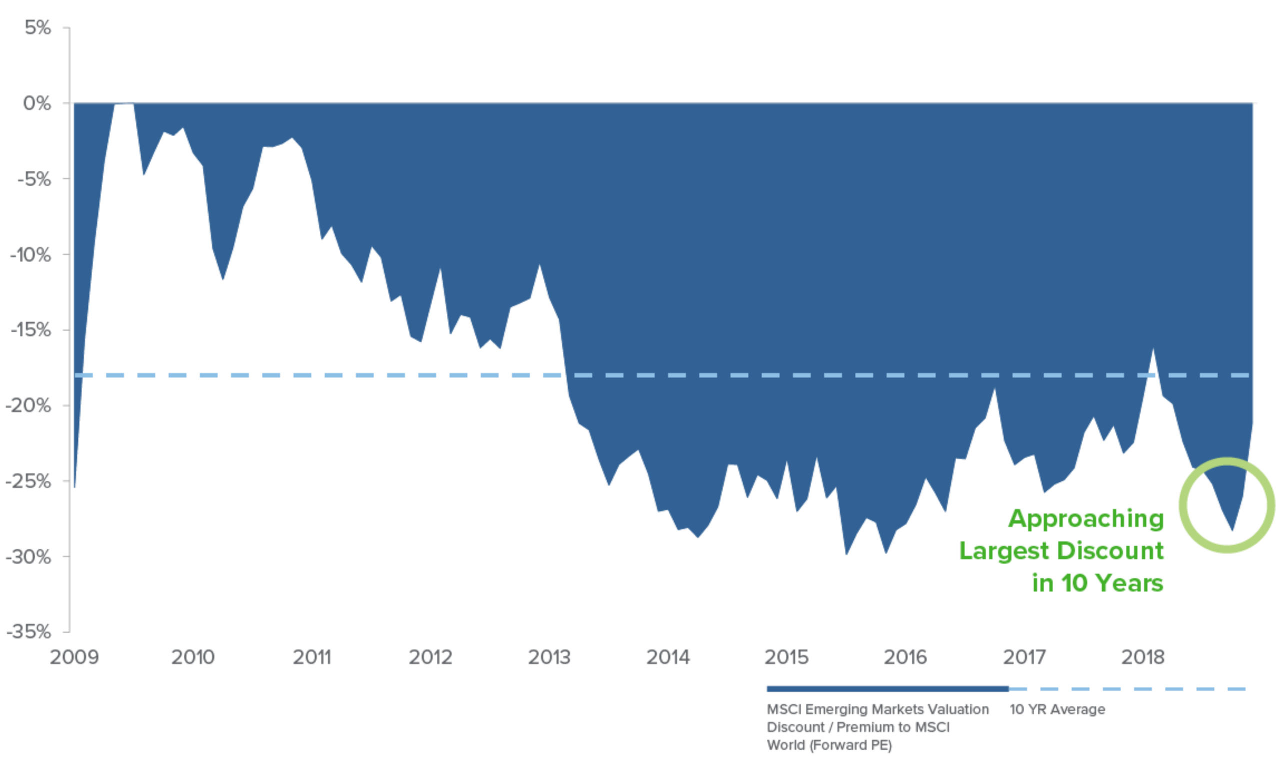
Robust Growth at Attractive Valuations

As investors think about asset allocation heading into 2019, the opportunity in Emerging Markets is not solely the noteworthy growth. EM's valuations are also attractive at current levels on both an absolute basis compared to historical average and on a relative basis when compared to developed markets' valuations. Currently, EM valuations are nearing 5-year lows on a forward P/E basis. Similar to GDP growth, the significance of the opportunity in EM is drastic when compared to DM economies. Emerging Markets are trading at around a 20% discount relative to Developed Markets. When evaluating the discount of EM compared to the DM, the average valuation discount has been approximately 18% over the last 10 years. We are now approaching the largest discount in a decade. Enticing valuations coupled with strong growth make the time to allocate more assets to Emerging Markets now.

Forward One Year Price to Earnings of Emerging Markets

Source: FactSet, December 2018

Historical Emerging Markets Valuation Discount to Developed Markets



Source: FactSet, December 2018

What You Need to Know Now in Emerging Markets

Local Drivers for Emerging Markets Growth

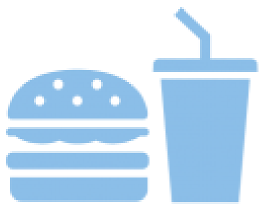
The growth opportunity in Emerging Markets is determined by local drivers that benefit the local EM consumer. The key to investing across market caps in Emerging Markets is on the ground research that goes beyond the countries to the consumer. We believe that visits with companies and their management teams are critical to understanding the long-term earnings potential for a firm. While traveling throughout EM countries, our analysts speak with locals to research consumer sentiment. They venture to shopping malls and restaurants to see consumer confidence trends and to see if what the government is reporting are the realities for the everyday consumer. Through bottom-up fundamental research, we at Westwood believe that the future of EM can be shown through the changing consumer trends.

Demographic Dividend

Many developing countries are currently experiencing a demographic window of opportunity also called the demographic dividend. In countries like India and Indonesia with a younger population base, the growing population of working-age labor force will be beneficial for economic growth. For example, 62 percent of Brazilians are 29 years old or under, whereas in China, almost 70 percent of population is above the age of 25. The benefits of a demographic dividend are seen not only in the case of simple retail sales, but growing consumption of services such as banking, telecommunication, restaurants and education services will reap the benefits of a more robust working-age population with more disposable income.

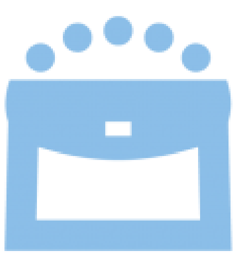
Mall Madness

Emerging markets retail developers have learned from developed markets on what not to do for shopping malls. They are changing the shopping mall experience for EM consumers. Emerging markets developers have shifted the mall culture to be more dining and entertainment driven. In countries such as Brazil, Thailand, China and the Philippines, shopping malls are focused on becoming lifestyle and destination centers for consumers. While people are migrating to cities where housing is smaller than in rural areas, shopping malls are becoming a bazaar for recreation and comradery.



Food Fast.

In developing countries, there is a culture shift from eating at street vendors, a more traditional style, to eating at global chains. In Mexico, despite a volatile year and a fluctuating currency, consumers have been frequenting quick service restaurants (QSR) chains like Burger King and Domino's. The global QSR market is anticipated to grow more than 4.2 percent between 2017 and 2022, according to a new Zion Market Research report. With the rising hectic lifestyle of dual income families, the demand for fast food is projected to increase. The growing need for inexpensive food fast will prompt the fast food industry to grow. Another market that is booming from the need for food fast is the fast-moving consumer goods (FMCG) market. According to Nielsen[1], the growth of FMCG is emerging markets is two to four times higher than in developed markets. By evaluating 'non-essentials', beer and snacks reveal that consumers in emerging markets are ready and able to spend beyond the bare necessities.



Growing Palate for Luxury Goods

Across emerging markets, an expanding consuming class is fueling demand for cinemas, restaurants and banking services. In China, $1.25 of every $10 of consumption growth between 2015 and 2030 is expected to be in education as the young and working invest heavily in the next generation. Many cities in emerging countries will be home to rising numbers of consumers with considerable and growing purchasing power. Roughly 700 large cities in China alone will account for $7 trillion, or 30 percent, of global urban consumption growth to 2030.[2] Sales in Asia, Latin America, the Middle East and Africa combined will rise above 50 per cent of global luxury consumption and continue to increase in subsequent years.[3] The appetite for luxury goods is increasing as a new wave of consumers continue to develop and add to the more affluent middle-income tier in emerging markets regions.

Going Further in Emerging Markets

Managing the minefield of Emerging Markets risks can seem daunting. There are a multitude of intricate risk factors that demand attention such as sifting through numerous countries, currencies and staying current on geopolitics at play. Investing in Emerging Markets requires active skill. A risk-controlled approach and emphasis on investing in quality businesses can mitigate the seemingly unmanageable risks. We at Westwood have developed a repeatable process that can identify quality companies with growth potential through bottom-up, fundamental research. We invest in sound businesses across small, mid and large caps that are mispriced and can generate positive and sustainable earnings growth, thus achieving economic profits over time.

Our benchmark agnostic investment approach is focused on investing in sound businesses around the globe. While seeking quality and growth, we utilize Economic Value Added (EVA) to identify well-run businesses with strong cash flow generation, consistent earnings and dividend potential. Our portfolios also value high standards of risk management by utilizing disciplined liquidity and quality screens to ensure proper diversification. We invest with a minimum three-to five-year time horizon while emphasizing high active share and low turnover. Our tried and true process has positioned the portfolios to benefit from long-term structural growth through the evolution of many Emerging Markets economies. By the avoidance of herd mentality and temptation to chase trends, our portfolios are constructed for long term investors seeking alpha through fundamental bottom-up research. Through our boots on the ground approach, we invest in companies in emerging markets, not just emerging market countries.

Capture the Growth Opportunity, learn more about Westwood's active, risk managed approach to investing in Emerging Markets.

[1]Nielsen, *What's Next in Emerging Markets*, February 2018

[2]McKinsey Global Institute, *Urban World: The Global Consumers To Watch,* April 2016

[3]Deloitte, *Global Powers of Luxury Goods*, May 2018

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