EDISON

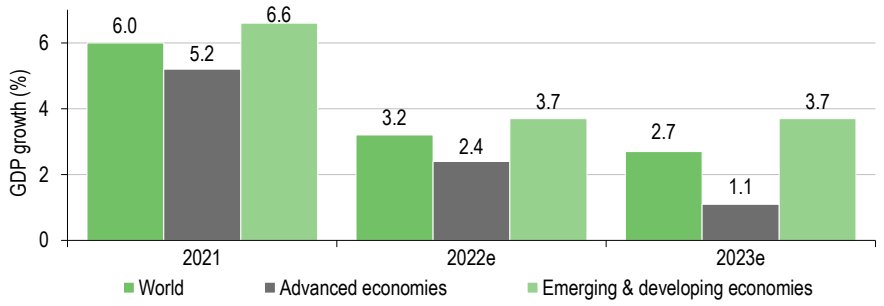
Templeton Emerging Markets IT

Good opportunity to revisit an unloved asset class

Investment trusts
Emerging markets equities

Templeton Emerging Markets Investment Trust (TEMIT) has experienced a difficult period of performance in recent quarters as investors have focused on the tough macroeconomic backdrop rather than on individual company fundamentals. However, managers Chetan Sehgal (lead manager) and Andrew Ness are confident in the long-term strategy of investing in companies with sustainable earnings power that are trading at a discount to their estimated intrinsic values. They believe emerging markets are under-owned and undervalued; hence, it is a compelling time to consider an allocation to the regions. The global asset allocation to emerging markets is 6.5% versus an 11.0% index weighting, which has declined by 40% over the last 10 years. Also, in aggregate, the valuation of emerging market shares is almost at a historic low discount to those in developed markets, while they are very inexpensive compared with their own history.

Higher growth potential in emerging and developing economies



Source: International Monetary Fund World Economic Outlook October 2022, Edison Investment Research

The analyst's view

Emerging markets have multiple drivers supporting long-term earnings growth, including consumer under-penetration and exposure to growth themes such as increased digitisation. Dividends are an increasingly important feature in emerging markets, having generated c 3% of the average c 9% annual total returns for investors based on long-term average rolling five-year returns (source: TEMIT). Ness reports that 20% of the trust's portfolio has a dividend yield above 5%.

Investor risk aversion evident in lower valuation

Investment trust discounts have generally widened this year in an environment of increased risk aversion. TEMIT is no exception as its 13.1% share price discount to cum-income NAV is wider than the 11.0% to 12.2% range of average discounts over the last one, three, five and 10 years. Given the positive relative growth prospects and attractive valuations of emerging compared with developed markets, global investors may benefit from an allocation to a large, well-established emerging market fund that has a clearly defined philosophy and investment approach, especially when investors return to focusing on companies with favourable fundamentals rather than trying to anticipate macroeconomic developments.

7 November 2022

Price	**139.4p**
Market cap	**£1,624m**
AUM	**£1,950m**

NAV*		160.4p
Discount to NAV		13.1%
*Including income. At 4 November 2022.		
Yield		2.7%
Ordinary shares in issue		1,164.9m
Code/ISIN		TEM/GB00BKPG0S09
Primary exchange		LSE
AIC sector		Global Emerging Markets
Financial year end		31 March
52-week high/low	189.2p	130.6p
NAV* high/low	209.0p	150.3p
*Including income		
Net gearing*		0.0%
*At 30 September 2022		

Fund objective

Launched in June 1989, Templeton Emerging Markets Investment Trust was one of the first emerging markets funds in the UK. The trust seeks long-term capital appreciation through investment in companies operating in emerging markets or listed on the stock markets of such countries. This may include companies that have a significant amount of their revenues in emerging markets but are listed on stock exchanges in developed countries. Performance is benchmarked against the MSCI Emerging Markets Index.

Bull points

- Large, diversified fund run by two experienced managers.
- Managers are part of a well-resourced team of more than 70 investment professionals based in 13 countries around the world.
- Potential for a narrower discount.

Bear points

- Tough period of relative performance since Q221.
- Emerging markets can be more volatile than developed markets.
- Stable ordinary annual dividends for the past three financial years.

Analyst

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Edison profile page

Templeton Emerging Markets Investment Trust is a research client of Edison Investment Research Limited

The fund managers: Chetan Sehgal and Andrew Ness

The manager's view: Tough macroeconomic backdrop

Ness comments that global markets have been 'challenging' this year; for the first nine months of 2022, the MSCI World Index declined by 25.4% and the MSCI Emerging Markets Index by 27.2% (both in US dollar terms). According to the manager, the macroeconomic backdrop is not being helped by the ongoing war in Ukraine. Higher inflation and a strong US dollar are leading to interest rate hikes in developed markets, the magnitude and timing of which have not been seen in many years. While COVID-19 no longer dominates the headlines, Ness is nervous about the potential for a bad UK flu season, while China's zero-COVID-19 policy is weighing on its economic activity. The manager also points to the global climate crisis, including the devastating floods in Pakistan, commenting that the world is changing and the need to transition away from fossil fuels will bring costs and burdens for companies and consumers, which is a headwind to economic growth.

However, Ness is relatively upbeat about the prospects for emerging economies, which he considers to be more resilient due to an improved policy environment. Despite this, the manager says that emerging market equities is an asset class that is 'unloved, under-owned, undervalued and underappreciated'.

Ness reiterates that TEMIT offers a high-conviction portfolio of best ideas, with the two managers being part of a team of more than 70 investment professionals located in 13 countries. The fund has exposure across the market cap spectrum and the managers are also able to invest up to 10% of the portfolio in pre-IPO companies, although they have not done so yet. There is an emphasis on good corporate governance and the managers focus on businesses with sustainable earnings power that are trading at a discount to their intrinsic value.

The manager highlights what he considers to be the new emerging markets landscape. He says that institutions in these regions have made policy improvements that should contribute to increased economic resilience during times of stress. He opines that emerging markets are underappreciated, despite having employed orthodox monetary and fiscal policies; the regions did not experiment with negative real interest rates in recent years and there was a lack of aggressive fiscal support during the pandemic, avoiding big hits to government balance sheets. Emerging market central banks have been proactive by raising interest rates in response to higher inflation and some countries have largely finished tightening rates. For example, in Brazil, the next move is likely to be down as the base rate rose from 2.00% in March 2021 to 13.75% and inflation is coming down (c 7% now compared with c 12% in April 2022). Ness also explains that emerging markets are typically less levered than developed markets at the government, corporate and household levels. He also highlights how emerging market economies have diversified, with consumption and technology providing secular growth drivers. The manager believes that investors are underestimating the resilience and quality of some emerging market companies and the regions are home to some of the most innovative technology companies in the world, including those involved in the development of electric vehicles, electric vehicle batteries and the transition towards renewable energy. Ness says that some emerging market companies have been leapfrogging established business models in developed markets through innovation and technology advancements.

Current portfolio positioning

TEMIT's top 10 holdings represent a range of countries and sectors, and these companies tend to be respective industry leaders that can navigate challenging environments. At-end-September 2022

they made up 46.6% of the portfolio, which was a noticeably lower concentration compared with 55.1% 12 months before; eight positions were common to both periods.

Exhibit 1: Top 10 holdings (at 30 September 2022)

Company	Country	Sector	Portfolio weight %	
			30 Sept 2022	30 Sept 2021*
Taiwan Semiconductor Manufacturing	Taiwan	Information technology	10.3	12.5
ICICI Bank	India	Financials	6.8	4.6
Samsung Electronics	South Korea	Information technology	5.8	10.7
Alibaba	China/Hong Kong	Consumer discretionary	5.5	6.2
Tencent	China/Hong Kong	Communication services	4.0	6.4
MediaTek	Taiwan	Information technology	3.4	3.2
Petróleo Brasileiro (Petrobras)	Brazil	Energy	2.8	N/A
Banco Bradesco	Brazil	Financials	2.7	N/A
Naver Corporation	South Korea	Communication services	2.7	3.9
China Merchants Bank	China/Hong Kong	Financials	2.6	2.4
Top 10 (% of portfolio)			**46.6**	**55.1**

Source: TEMIT, Edison Investment Research. Note: *N/A where not in September 2021 top 10.

Over the 12 months to end-September 2022, the largest portfolio changes on a sector basis were a higher exposure to financials (+5.4pp) and lower weightings to communication services (-5.5pp) and technology (-4.2pp). Compared with the benchmark, TEMIT's largest overweight positions are technology (+9.7pp), despite this being one of the largest reductions in sector exposure, and financials (+4.0pp), while the largest underweight position is utilities (-3.1pp).

Exhibit 2: Portfolio sector exposure versus benchmark (% unless stated)

	Portfolio end-Sept 2022	Portfolio end-Sept 2021	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Information technology	28.0	32.2	(4.2)	18.3	9.7	1.5
Financials	26.6	21.2	5.4	22.6	4.0	1.2
Consumer discretionary	13.0	12.7	0.3	14.0	(1.0)	0.9
Communication services	9.2	14.7	(5.5)	9.7	(0.5)	0.9
Materials	8.2	7.7	0.5	8.8	(0.6)	0.9
Industrials	4.4	2.4	2.0	5.8	(1.4)	0.8
Consumer staples	4.3	3.9	0.4	6.6	(2.3)	0.7
Energy	3.2	2.9	0.3	5.3	(2.1)	0.6
Healthcare	1.8	1.1	0.7	3.9	(2.1)	0.5
Real estate	0.5	1.2	(0.7)	2.0	(1.5)	0.3
Utilities	0.1	0.0	0.1	3.2	(3.1)	0.0
Other net assets	0.7	0.0	0.7	0.0	0.7	N/A
	100.0	**100.0**		**100.0**		

Source: TEMIT, Edison Investment Research. Note: Numbers subject to rounding.

In terms of TEMIT's geographic exposure, the largest changes over the 12 months to end-September 2022 are Brazil (+5.0pp) and the rest of the world (-8.2pp). Notable variations compared with the benchmark are overweight exposures to South Korea (+6.7pp) and Brazil (+5.3pp) and an underweight exposure to the rest of the world (-14.5pp).

Exhibit 3: Portfolio geographic exposure versus benchmark (% unless stated)

	Portfolio end-Sept 2022	Portfolio end-Sept 2021	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
China	27.7	29.2	(1.5)	31.3	(3.6)	0.9
South Korea	17.4	21.8	(4.4)	10.7	6.7	1.6
Taiwan	14.7	16.7	(2.0)	13.8	0.9	1.1
India	12.4	7.9	4.5	15.3	(2.9)	0.8
Brazil	11.1	6.1	5.0	5.8	5.3	1.9
US	3.9	1.5	2.4	0.0	3.9	N/A
Thailand	2.5	1.5	1.0	2.1	0.4	1.2
Mexico	2.0	1.4	0.6	2.2	(0.2)	0.9
UK	1.8	1.4	0.4	0.0	1.8	N/A
Hong Kong	1.5	0.0	1.5	0.0	1.5	N/A
Rest of the world	4.3	12.5	(8.2)	18.8	(14.5)	0.2
Other net assets	0.7	0.0	0.7	0.0	0.7	N/A
	100.0	**100.0**		**100.0**		

Source: TEMIT, Edison Investment Research. Note: Numbers subject to rounding.

Ness highlights some of the most important portfolio transactions in Q322. There is a new holding in **HDFC Bank**, which is the largest private-sector bank in India with a strong presence in the retail segment. The manager says that the company should be an important beneficiary of the long-term growth potential in India, with a possibility of a cyclical uptick over the next few years. India-listed **Zomato** was added to TEMIT's portfolio as it has a strong standing in the food delivery market, which Ness expects to grow in the medium term. There is also a new position in **Banco Santander Chile**, which is the largest financial institution in the country. Sales included Brazilian financial exchange **B3** and food-delivery firm **Delivery Hero**.

Performance: Looking forward to better results

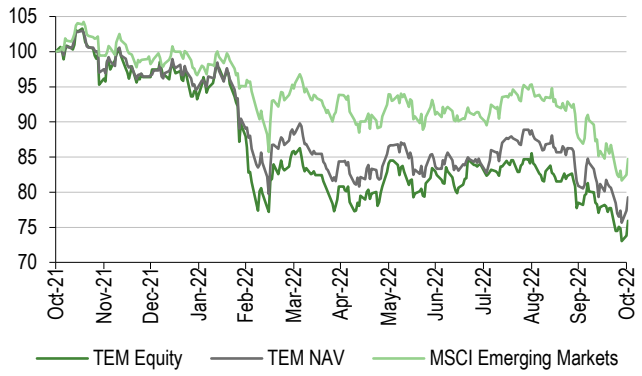
Exhibit 4: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	MSCI Emerging Markets (%)	MSCI World (%)	CBOE UK All Companies (%)
31/10/18	(11.3)	(11.8)	(8.7)	5.7	(1.6)
31/10/19	15.2	17.0	10.9	11.9	6.9
31/10/20	15.7	12.0	8.7	5.0	(20.2)
31/10/21	11.2	9.2	10.7	33.0	36.0
31/10/22	(26.2)	(22.6)	(17.5)	(2.5)	(1.6)

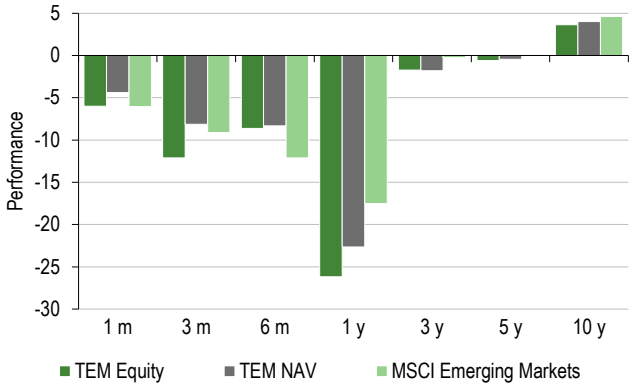
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Exhibit 5: Investment trust performance to 31 October 2022

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to MSCI Emerging Markets	0.1	(3.3)	4.0	(10.5)	(4.3)	(3.4)	(8.9)
NAV relative to MSCI Emerging Markets	1.8	1.1	4.3	(6.2)	(4.6)	(2.7)	(5.7)
Price relative to MSCI World	(9.6)	(10.8)	(9.1)	(24.3)	(30.3)	(39.8)	(58.8)
NAV relative to MSCI World	(8.0)	(6.8)	(8.7)	(20.7)	(30.5)	(39.4)	(57.4)
Price relative to CBOE UK All Companies	(9.0)	(8.2)	(3.7)	(25.0)	(11.0)	(13.6)	(22.2)
NAV relative to CBOE UK All Companies	(7.5)	(4.0)	(3.4)	(21.4)	(11.3)	(13.0)	(19.5)

Source: Refinitiv, Edison Investment Research. Note: Data to end-September 2022. Geometric calculation.

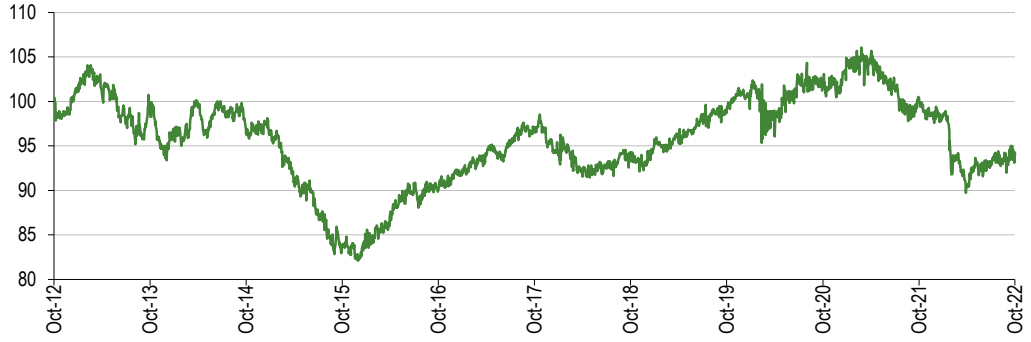
TEMIT's relative performance has improved in recent months, although its NAV total return lags that of the benchmark over the last one, three, five and 10 years. Ness explains that this year has been a very challenging environment for stock pickers as markets have been driven by top-down factors. He stresses the importance of remaining steadfast to the philosophy of focusing on companies that have sustainable earnings growth that are trading at a discount to their intrinsic worth.

The manager highlights that TEMIT's Russian exposure had a meaningful negative impact on the trust's performance. These shares were written down to zero in the first week of March 2022. However, there was also an indirect impact from Russia's invasion of Ukraine as the Saudi Arabian stock market was very strong due to high oil and gas prices and positive fund flows as investors

sought to maintain their energy exposure. TEMIT does not have any Saudi Arabia-listed shares, which has turned into a performance tailwind in recent months as they have pulled back.

Ness says that China has been a difficult market to navigate this year given its zero-COVID-19 policy and regulatory crackdown, which have negatively affected a range of industries, especially internet companies. However, he believes that we are closer to the end of increased regulatory scrutiny than the beginning.

Exhibit 7: NAV total return performance relative to benchmark over 10 years



Source: Refinitiv, Edison Investment Research

Peer group comparison

TEMIT is the largest of 11 funds in the AIC Global Emerging Markets sector by a considerable margin. The trust has had a tricky period of absolute and relative performance over the last 12 months with its NAV total return ranking eighth. It ranks ninth out of 11 funds, eighth out of 10 funds and seventh out of nine funds over the last three, five and 10 years respectively. Comparing TEMIT with the two funds that its managers consider its closest peers, Fidelity Emerging Markets and JPMorgan Emerging Markets Investment Trust, TEMIT ranks first out of the three funds over the last 12 months and second over the other periods shown.

The trust's discount is narrowly wider than the sector average and it has a competitive ongoing charge, which is c 30bp below the mean. In line with the majority of its peers, TEMIT is currently ungeared, and it has a modestly below-average dividend yield.

Exhibit 8: Global Emerging Markets peer group at 4 November 2022*

% unless stated	Market cap (£m)	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (cum fair)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Templeton Emerging Mkts Inv Trust	1,623.9	(21.3)	(4.6)	(1.2)	50.3	(13.1)	1.0	No	100	2.7
Africa Opportunity	12.4	6.3	69.7	21.2	65.0	(27.0)	2.0	No	100	2.3
Barings Emerging EMEA Opps	56.6	(29.5)	(23.1)	(12.1)	18.5	(28.4)	1.7	No	100	5.5
BlackRock Frontiers	246.6	4.0	27.3	18.5	152.7	(11.1)	1.3	Yes	109	4.1
Fidelity Emerging Markets	548.7	(27.3)	(16.2)	(9.4)	35.8	(14.2)	0.6	No	100	2.7
Fundsmith Emerging Equities Trust	336.5	(12.9)	7.4	16.2		(5.9)	1.3	No	100	0.2
Gulf Investment Fund	76.9	34.1	94.9	160.3	286.0	1.4	1.7	No	100	3.3
JPMorgan Emerging Markets Inv Tr	1,162.1	(22.1)	8.9	24.2	103.1	(11.6)	0.8	No	100	1.4
JPMorgan Global Emerging Mkts Inc	342.7	(13.8)	7.1	17.7	73.9	(13.3)	0.9	No	110	4.5
Mobius Investment Trust	134.8	(18.0)	40.2			(2.6)	1.5	No	100	0.3
Utilico Emerging Markets	436.7	7.4	6.5	16.3	93.8	(15.8)	1.4	No	105	3.7
Average (11 funds)	**452.5**	**(8.5)**	**19.8**	**25.2**	**97.7**	**(12.9)**	**1.3**		**102**	**2.8**
TEM rank in peer group	**1**	**8**	**9**	**8**	**7**	**6**	**4**		**4=**	**6**

Source: Morningstar, Edison Investment Research. Note: *Performance at 4 November 2022 based on ex-par NAVs. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

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