Spotlight: *Investment Data in Emerging Markets*

A conversation with Lilian Quah, CFA — Managing Director, Portfolio Manager and Head of Quantitative Research

QUESTION. *How has the availability of data on emerging market companies changed over the years?*

ANSWER. Contrary to popular belief, the availability of financial statement data for emerging market companies is quite good and has been for some time. In fact, 20 years of high-quality reported financial data for companies in our emerging market investable universe is readily available. For Epoch specifically the majority of the measures used in our Core Model (our proprietary stock selection model) have coverage of around 80% to 90% throughout this period.

Measures which rely on forward-looking estimates — e.g., broker forecasts of cash flows one year out or revisions to earnings estimates — are a bit more difficult to obtain, at least relative to most developed market companies. Over the last 10 years, this data is available for about half of the companies in our emerging markets universe; better than coverage for Japanese companies, but worse than that for European companies.

QUESTION. *Has the reliability of the data improved over time?*

ANSWER. Yes, over the past two decades, accounting standards in emerging market countries have converged toward International Financial Reporting Standards (IFRS), improving both the reliability and comparability of accounting data in these markets. Of course, there is still room for improvement. For example, fair value measurements of assets may be more difficult if there are few competent and reputable professional valuers and accountants in a country. Over time, we believe these challenges will get resolved as financial markets — and the institutional structures supporting them — deepen in these countries.

It is difficult to put a number on just how much better financial data has become over time, but I think we can assume that a purely systematic approach that relies on good quality data is easier to implement today than it would have been 25 years ago. Of course, we believe in thoroughly validating the data and complementing the reported numbers with deep fundamental research. This is why we use a hybrid approach to manage the strategy, an approach that blends the best aspects of our quantitative and fundamental research capabilities.

QUESTION. *Is the data interpreted or treated differently in distinct countries?*

ANSWER. I personally do not believe so. As mentioned, international accounting standards have converged over time, making it much easier to compare companies across countries. In addition, investor expectations for what constitutes corporate success and good corporate governance seem to be converging to developed market norms. This effect is likely driven by the expansion and globalization of the investor base for emerging market companies. Global institutional investors tend to bring a similar lens through which they view companies. They also tend to demand — through their proxy votes and/or direct interactions with company management teams — a certain level of disclosure and accountability.

QUESTION. *Emerging market companies typically have less sell-side analyst coverage. Does this impact the availability of data?*

ANSWER. Many publicly listed, emerging market companies are actually quite large — Chinese internet giant Alibaba is among the largest companies in the world and four of the top-10 largest banks in the world are Chinese — so not all companies lack sell-side coverage. There are, however, some companies that have insufficient or simply no sell-side analyst coverage. For those companies, you are not going to get very good consensus forecasts of earnings and cash flows. Practically, this means that we cannot use measures that rely on broker forecasts.

On the bright side, the lack of sell-side coverage suggests that a company may be less well-understood and potentially under-appreciated by the market. Active management is more likely to add value in these situations.

QUESTION. *Do asset managers need different data models to evaluate emerging market countries than they do for DM countries?*

ANSWER. The models don't necessarily have to differ, but comparisons should. For consistency and simplicity, we have chosen to use the same framework to evaluate all companies in our global all-cap, all-country investable universe. This does not mean that we are comparing apples to oranges, however. Each company in our universe is evaluated versus its relevant peer group, which is typically the set of companies within its industry group and region (or in the case of globalized industries, such as energy and semiconductors, the set of companies within its industry group). Narrowing the comparison set to companies in the same region means that emerging market companies are considered separately from developed market companies. For example, Brazilian oil company Petrobras is compared to other emerging market energy companies, such as Saudi Aramco and China Petrochem, but not to developed market energy players, such as Royal Dutch Shell and Exxon.

I believe the more critical differences between companies stem from issues with the accounting treatment of certain economic activities and to sector differences. We have spent a considerable amount of time, thought and effort to address these differences in our Core Model. However, this is a topic for another conversation.

QUESTION. *As you enter your strategy's third year, what excites you about the data coming from the emerging markets?*

ANSWER. The short answer is that there is more and more of it. The amount of data being generated today is rather mind-boggling and not limited to developed markets. Moreover, it takes a lot of skill and expertise to extract high-quality insights from these new data sources. To me, this is both a challenge and an opportunity. I believe a key driver of success as an active manager is the ability to efficiently process and extract value from data. Data-driven decisions tend be higher quality, more repeatable and more successful. We are working hard to evolve our infrastructure, tools and skills to make sure that we are well-positioned to take advantage of this trend.

Lilian is a portfolio manager, the head of quantitative research, and a member of the Quantitative Research and Risk Management team. Prior to joining Epoch in 2013, she spent five years at AllianceBernstein, where she was a senior quantitative analyst in the Value Equities Group. Before Bernstein, Lilian was a senior consultant in the finance practice at the ERS Group, an economics consulting firm. Lilian has a BA in Economics from Wellesley College and a Masters in Economics from Stanford University. Lilian is a CFA charterholder.