Transcript

Better conversations. Better outcomes.

Episode 38 – Emerging markets

Thomas Vester - What you expect from investing in emerging markets is improved return to your portfolio, because frankly, you might as well just stay at home if you don't think it will add anything to your portfolio. At the end of the day, you've got to require better returns than you can get at home. So that's what you should expect, and that's the wonderful thing. When you look at S&P 500 and everybody's reporting you haven't seen revenue grow for six consecutive quarters, we're not seeing that, we're seeing a lot of revenue growth from companies selling very, very traditional products because the consumer base is growing and they're getting wealthier, so they can buy more of it, so we are very, very optimistic about the long-term return we can generate for our clients in these markets in hard currency after cost. You've just got to have a long-term view.

Ben Jones - Welcome to Better conversations. Better outcomes. presented by BMO Global Asset Management. I'm Ben Jones.

Emily Larsen - And I'm Emily Larson. In each episode, we'll explore topics relevant to today's trusted financial advisors, interviewing experts and investigating the world of wealth advising from every angle. We'll also provide you with actionable ideas designed to improve outcomes for advisors and their clients.

Ben Jones - To access the resources we discuss in today's show, or just to learn more about our guests, visit bmogam.com/betterconversations. Again, that's bmogam.com/betterconversations. Thanks for joining us.

Emily Larsen - Before we get started, one quick request. If you have enjoyed the show and found them of value, please take a moment to leave us a rating or a review on iTunes. It would really mean a lot to us.

Disclosure - The views expressed here are those of the participants and not those of BMO Global Asset Management, its affiliates, or subsidiaries.

Thomas Vester - My name is Thomas Vester. I'm chief investment officer and senior portfolio manager for LGM Investments, part of BMO Global Asset Management.

Ben Jones - The last time that you and I had a chance to sit down and have dinner was in London, and one of the things that really struck me was how passionate you are about the emerging and frontier markets, and investing in general, so for our audience's benefit, could you just tell me a little bit about your story and what drew you to investing in emerging markets and why that became your life's work?

Thomas Vester - Yeah, absolutely, Ben, and you're absolutely right, this is a complete blessing, to be able to combine something you're so passionate about, your hobby, in terms of investing, combine it with being your work and being so fortunate that you have investors who believe in you, so you can do it full-time, which is absolutely terrific.

Ben Jones - Emerging markets have been on a tear this year, but investing in emerging markets is no short-term tactic. The topic of emerging markets, and frontier markets for that matter, ultimately gets down to the basics of investing. Buying part of a company that you believe has the potential to grow over the long-term. And when we say long-term in emerging markets, we don't mean a quarter, or one or two years, we mean long-term. Our guest, Thomas Vester, and his team at LGM, have made it their life's work to find investable companies in emerging markets and many of those companies are providing basic staples, such as milk or beer or cookies. They invest in them not for their potential to be large, global conglomerates, but instead for their potential for steady growth in their own country and region.

Emily Larsen - You'll also notice, throughout this interview, that emerging market investing has to factor in a lot of variables, like geopolitical, cultural, and technical trends, in addition to understanding how stable is the government, a country, a currency, and even asking questions like is the country running itself like a good business, or is it spending more than it makes.

Ben Jones - And today, we're going to cover a number of these variables, as well as current market events. As Thomas said at the open, you've got to take a long-term view, and Thomas and his team look to the horizon when making decisions for client portfolios. In fact, a 5 to 10 year timeline is completely normal for them. In a way, their long-term horizons might be similar to the way one might look at certain illiquid investments, such as private equity or real estate. Thomas and I spoke about why advisors need to pay attention to emerging markets and what they have to offer in the context of a portfolio.

Thomas Vester - This is just a blessing, to be able to invest in markets that are coming from such an early stage, compared to U.S. and European or Japanese equity markets, where you have endless amount of people following the same stock, an endless amount of analysts covering the same stocks, and you see people are so focused on quarterly estimates and are you going to beat or miss consensus. Most of our investments, we don't have consensus, because there's no one following these stocks, so you've got to go out and meet the companies and really do the due diligence yourself, and that also means that you have access, as we talked about in Tanzania, sitting down with the CEO, the CFO, yesterday sitting down with the prime minister of the country I went to, to discuss our investment. There's really access, here, to very, very senior people, because they're very interested in what we're bringing. Yes, we're bringing capital to invest, but we also bring strategic advice, something that is listened to very, very carefully, so as we're taking a long-term partnership with our clients, we're taking a long-term partnership with the companies that we invest in and develop this for the long run. So yes, I'm hugely passionate about the opportunity we have.

Ben Jones - That's fantastic. Now, most of the advisors who listen to this show are located in fairly developed markets, and so everybody's got a little bit of home country bias, but emerging markets over the last 10 years or so has been a portion of most peoples' portfolio. Why do you think that advisors should care about emerging markets for their clients, and what are the specific things they should think about when they think about an emerging market allocation?

Thomas Vester - I think you should care about emerging markets because they are becoming an increasingly important part of our world. Emerging markets, be it China, Brazil, India, South Africa, Mexico, a wide range of countries covering a very significant part of this world's population, an ever-increasing part of this world's GDP, and a significant part of this world's consumption. Try and listen in to investor calls at Unilevel, Coca-Cola, having sections about the emerging markets, because they know it's an important part of their profitability, their cash generation long-term. From an investment perspective, it can be equally important. The great thing about emerging markets is that you have a very significant opportunity to go off and find companies that sell a product that you and me, Ben, and people listening to this call, we take for granted. When you look at what LGM investments invest in, we have a significant part of our clients' capital invested in something we would regard as very basic industry, such as dairy companies, selling milk. We take milk for granted, we think the only real choice when we want to buy some milk is whether or not it should be full fat or non-fat or it should be organic or non-organic, but in these markets, milk is a very, very discretionary item. It's something where you've really got to look at your wallet and say can I afford to buy the milk I want for the next week, and you fight to cover that need, because you want to provide your kids the best start in life. You might sacrifice your need, but you will fight to cover it for your own kids. Beer, I mean when have you last time looked in your wallet to say if I can afford a beer when I get home from work today? No, you don't do that, because you know, at the end of the day, from your disposable income, it's a fairly minor cost. If you live in Tanzania or you live in Vietnam or you live in Columbia, it might really be something you have to consider, if I'm going to allow myself to have a beer or soft drink after work today, and therefore, we also clearly are aware that we are in some companies, as these economies grow, the upside potential is very, very significant, especially if you can partner with companies that treat minority shareholders, as we are, very respectfully, very fairly, then they can be a great upside for investors for the long run, but you've got to take a long-term view.

Ben Jones - How do you think about defining emerging markets, because I think most people think about the BRICs, Brazil, Russia, India, China, but it's a much bigger universe than that. There's a lot of other countries in the universe, and then also we've got this other category, and I know you run a frontier markets fund. How do you think about the difference between emerging and frontier and is there any switchover between the two?

Thomas Vester - Yeah, I mean, let me start out with saying something that might be found a little bit controversial to parts of our audience, but MSCI or FTSE or S&P, whoever the industry definers -- whoever is out there, defining the markets and the indices, they're not here as a charity. They're not here to provide better long-term investor returns long-term. They're running a business and their focus is on running a business, so they maximize value for their shareholders long-term, and in general, one should have the courage to step away and look at the market and say what does actually make sense for my capital long-term, and that's exactly what we've done here at LGM. When we look at emerging markets, we're saying what is actually emerging markets. Emerging markets, to us, is consumers coming from a low economic base and moving into a little bit better base where, let's say you go from being early stage middle income to being more mature stage middle income, so where you go from let's say having $50 of disposable income a month, maybe in some years to go $200 to $500 disposable income a month, and follow that consumption pattern, what products are the consumer demanding when they move from being early stage middle income to later stage middle income, and that is products such as milk, beer, cookies, all the kinds of consumer goods, laundry detergents, et cetera. Basically things you eat, things you wear, things you sleep in. Ultimately, if you get a formal employed job, you need a bank account, then maybe you want to take out a loan to finance a car. Maybe you want to insure that car. So you can see the whole cycle of products ranging. That is emerging markets to us. And that's how we define emerging markets. So Ben, when you look at our portfolio, you will see we have basically ripped off the definition of emerging markets by the industry definers, MSCI, et cetera, and then we have concentrated on what is true emerging market. Economies coming from a low economic base and tailor it to the domestic consumption. So when you look at our emerging market portfolio, you see a very significant part of the invested capital in countries like India, Philippines, Indonesia, Mexico, South Africa. All economies coming from that low economic base. MSCI has the biggest part of their EM index in countries like Taiwan, South Korea, and China. Frankly, South Korea and Taiwan, they're more developed markets than some of the developed markets are, if you compare the living standards and GDP per capital in South Korea, Taiwan, to those of southern Europe. I think where most people would choose to be from an economic standpoint, maybe not well on other factors, but at least from an economic standpoint, they would be better off living in South Korea or Taiwan. So we have made a very long-term definition here, to make sure we are doing what is best for our clients' capital. And then moving on to frontier markets, Ben, frankly, it's just markets that are a little bit poorer than emerging markets. So even at earliest stage cycle, so you could see where the frontier, that's probably when you go from being poor to being early stage middle income. So that just makes the consumption pattern even more emergent. And then we're focusing across all our strategies, being global emerging markets, frontier, global emerging markets small cap, A share India, we're focusing on a domestic range of companies. You won't find us investing in the Samsung, the companies that are selling products to you and me. We invest in the companies that sell a product to the local consumer. So when the consumer, whether he is in Mexico City, in Ho Chi Minh City, in Carache, in Nairobi, when he goes from having a little bit of disposable income to having a little bit more, we want to be in the companies that sell the product that he's going to consume.

Emily Larsen - Beer, milk, and cookies? These are my kind of products. Or, at least, Ben's. And the kinds of products your clients may invest in, with emerging markets exposure. Many trends are pushing emerging markets to new levels of wealth. Thomas tackles how to think about some of them.

Thomas Vester - Populations are growing. Populations are growing in India. Less so in China, because of the one child policy. Population is growing very significantly across Africa. In Africa today, you've got around 800M people, but it's growing very, very rapidly, and it's a huge opportunity for these markets in terms of if you can sell products to these consumers as they grow. Social media, access to internet, has made it a lot more brand aware. Consumers know exactly what they want, so if you don't have it, you are out of business, but on the contrary, if you've got it, you have a phenomenal upside. I will, however, also say, Ben, that one's got to be careful with population. Population growth is only a good thing if you can create jobs. One thing we've got to ensure is that we have job growth in these markets. It's absolutely key, because if you don't have job growth, you might have a lot of unemployed young people, and that can really cause social unrest long-term if that's the case. So that's also why it's fairly important to have a strong view in the countries you invest in for the long run.

Ben Jones - And I know demographics plays a big role in some of your thoughts, but I'm interested, are there any other secular trends, globally, that are driving some interesting things in the emerging markets.

Thomas Vester - Yeah, absolutely. I pointed to before, the access to knowledge, consumers know what products they want. They -- wherever you go in this world, you'll see a kid running around in a Real Madrid, a Barcelona football shirt, because they know exactly who the best ones are, because they have access to information. The same things they know about products you consume, things travel very, very quick. When I started doing this, Ben, you could go to countries and then you would hear let's say a music record that was number one in the U.S. two or three years ago, that was suddenly the hit thing in Tanzania. Today, that is instantly. As soon as it hits the market in the U.S., it hits the market in Africa, and it's going across, and it will be number one at the same time, because people have access via Spotify, et cetera, so these are very fast-moving trends, and it's significant opportunity if you have the right long-term strategy. I will also say that one should be careful with thinking we live in a world that will completely change, and we won't do the same thing at LGM. We very much believe yes, the world is changing, but we will still continue many of the same -- consume many of the same things 10 years, 20 years, 30 years from now, as we are today. Maybe food will -- is changing very much in developed markets how it gets sold, but it will still be consumed and brand loyalty will still be in place in 10 to 20 years' time. So we've also got to be careful with not thinking we should only pay very significant valuations for companies that we think will rule the world going forward, but we can find some great opportunities in what is considered very basic items in developed markets and make some great investments in basic categories in emerging markets and frontier markets.

Ben Jones - How do you even think about where to invest money. I think a lot of people, as I mentioned, think of the BRIC countries -- Brazil, Russia, India, China -- but there's Mexico, India, the Philippines, as you pointed out, Columbia, Malaysia, Chile. There's a lot of countries that make up the emerging markets, and how do you and your team think about where you should allocate capital, or do you even think of it at a country level?

Thomas Vester - Yeah, we -- I think the best way to explain it, Ben, is that we are always on the search for a great investment. We will always, no matter where it's located, if we see something where we think there's a great business selling at a good price, we will be there to do the research, and we will do the due diligence. Then of course we've got to look at things from a portfolio perspective. We cannot have too much of our clients' capital in the portfolio exposed to countries with, let's say twin deficits, because that always tends to haunt down and sooner or later, you will see problems in those countries. We cannot have too much in countries with too high an external debt to GDP, because that might be unsustainable, so we've got to monitor that from a portfolio perspective. We were very cautious not having too much, and this was prior to anyone talking about that the oil price could collapse, we were very careful not having too much in oil-exporting countries, because we understood that yes, maybe you're not invested in oil companies, but if you own banks and let's say insurance companies in oil-exporting nations, you might have a significant risk to collapse in the oil price. So we are very careful that we stay properly diversified at a portfolio level, because also ourselves as personal investors, we co-invest with our clients. We don't want to see too much volatility. It's very important for us that we run portfolios that, when the market drops, we drop significantly less than the market. One other thing that is important, Ben, is that we're here to make return for our clients in hard currency after costs. I normally say that I cannot see send my daughter to Yale or Harvard on a return in Kenyan shilling or Argentinean pesos. I can only do that on a return in U.S. dollars. So, when we make investments, we've got have a view on the currency we invest in that we believe it's good, because we've got to make return in U.S. dollars for our clients and we've got to have a strong view on the costs involved because we've got to make return in U.S. dollars after cost. So, it's absolutely crucial we have view on the currencies when we invest.

Ben Jones - Now, it's interesting that you bring that up because currency has been in the news a lot over the last 12 months or so. How do you think about currencies, and in particular, I think, you know, there's been accusations about some manipulation or central bank policies that have caused pretty big swings. How do you think about that and make sure that you avoid some of those currency traps?

Thomas Vester - We always look at what a currency -- what is like a fair value for the long run, and then you've got to take it into consideration what you're paying for the investment. We could have a situation, Ben, where, yes, I believe, let's say a currency of country X is a little bit overvalued. Let's say I think it could actually fall 10% to 15% over the next year, but if all of the investors know that and everybody is panicked because everybody is so fearful of that so the market has dropped 50%, I might actually buy it today because, again, I'm here to make returns in U.S. dollars. So, if I feel I will gain more on the investment side on the share price return, then I think that anyway I could lose in the currency, I might invest upfront. And then it also comes back a little bit Ben, to good old Russia who said invest with the sound of the cannons and retreat with the trumpet. Something we do here at LGM, we love when others get nervous because they -- one thing is true about investors. We tend to act as lemmings. I say we, but I definitely don't want to be included in that camp. But investors tend to act a little bit like lemmings, tend to follow each other because people are so focused on beating the benchmark in the next quarter or the next two couple of quarters. So, where if you have the courage to take a proper long-term view, we are very different. We're here for the long run. So, often you will see, like, when we had Trump being elected, yeah, we had some investments in Mexico, and they sold off very, very strongly. The Mexican peso sold off very strongly. What did we do? We just added more. We made a new investment and we just added significantly more in the investments we had because we didn't see that it was something to be that worried about and that had proven to be very right. We also saw our investments in India selling off strongly where when Prime Minister Modi had the courage to go out and actually fight corruption with the demonetization he did in October/November last year, something, again, that was very bold for the long run, but then investors started to say, hey, how will that impact EPS growth in the next quarter, and then people said that might actually hurt EPS growth, so let's sell these stocks, which we found very, very strange because he was actually trying to do the right thing for the long run and he actually did a bold policy move, something you and I living in the Western world, that is very rare, you find politicians doing bold, long-term moves. So, we actually bought a lot more in India. So, sometimes you have policy that go against you. You got to look why are they doing it, and then you've got to take a long-term view. What is my return potential here long-term in U.S. dollars? And then, Ben, you should never forget to be diversified. We hold in our portfolios at LGM between 30 to 60 stocks. If we ran a global fund, we would probably hold a little bit less. I know that might sound concentrated to some people, but we are here to -- we do our homework and we're here to hold concentrated portfolios, but we diversify more in emerging markets and in Frontier markets because sometimes bad things do happen, and we normally say when you could have like Madoff, Enron, etc. in the western world, you can surely something that is worse in emerging markets and frontier markets, so you've got to keep some diversification. And one other thing, Ben, if I just may point out, when you look at our portfolio, you see that our companies pay dividends, and we just want to see the companies sending money back year after year because those are the money you can really count on. Those are for real. Everything can be manipulated, if you will, in an earnings statement, but dividends they send back, those are for real, especially if it's coming out of a clean balance sheet with no leverage on the balance sheet, then we really like it, then we like to be long-term shareholders.

Ben Jones - There's been a lot of global events that have occurred, and you mentioned a couple of them. I mean, some bold moves out of India around kind of tax amnesty and demonetization. We've seen China with the MSCI announcement to include A shares. Maybe we could just talk about a couple of those really quick, and did you see -- have you -- are you still seeing impacts in India from demonetization or tax amnesty, or has that kind of washed through the system?

Thomas Vester - No, I mean, it's definitely still in the system, Ben, and I think the best way it's in the system is that nobody -- or, everybody knows today that this is for real and there was -- the demonetization caught a lot of people by surprise, so I think it has sent shockwaves through

India, both the formal economy and the informal economy, the political network, to understand that this is for real and we better play by the book. We'd better do what is appropriate because else we might get caught. And the same thing has happened in Brazil. It has sent shockwaves through the political system. I think it caught everyone by surprise how corrupt it actually was, but they're starting to clean it up, which is a good thing. So, we've definitely seen some very, very strong improvements, and you mentioned China where they also have been tackling corruption. So, we are in this little bit peculiar situation, Ben, where we actually have seen a couple of very big swings in the political landscapes in the western world with the elections you had yourself in the United States, with the Brexit vote in the country I live in, in the U.K., but we've also seen some very big changes in some of the countries that we invest in, in emerging markets where you're actually seeing some very strong policy moves for the long-term, so something we very strongly applaud, and something we think bodes very well for the future of emerging and frontier markets.

Ben Jones - That's great. Now, I know that given that the A shares news is fairly recent this summer, I know a lot of my listeners would be disappointed if I didn't get a chance to pick your brain on this, so what exactly is the announcement -- like, what really happened with this A share announcement and does it really change anything either for those companies or your thoughts on the markets. And I guess, you know, as you mentioned corruption, what is the state of kind of governance in China and does it change with this move?

Thomas Vester - Yeah, let me start with the latter part, Ben, I don’t this it changes anything in terms of how companies are run. I think one of the best examples is that you had actually a number of Chinese companies listed in the U.S. and there turned to be massive corruption there. So, I think we've proven that, that doesn't necessarily help anything in that regard. In terms of the announcement to include A shares, so shares listed in mainland China, not in Hong Kong, yeah, it frankly only skews the MSCI indices even more. So, China is already a very, very significant part of that index, and it's only going to make it even bigger. So, I would say from an investor point of view, if I had a passive investment in emerging markets, I would be a little bit upset, because it's only going to skew my investment more toward China and decrease the exposure I have to other interesting markets, such as India, Philippines, Indonesia, Mexico, etc. And I'm not saying China is uninteresting, I'm just saying that it's making it even more concentrated in China and the surrounding countries such as Taiwan and South Korea. What does it do for us, Ben? These announcements are always very interesting because sometimes you have an announcement, and then stocks rally, let's say 10%, 15% without any other reason, what do we do? We tend to sell. Because we own something before we thought that was worth X and now suddenly the market has just paid it up by 15%, then it doesn't make sense to own the same amount for us, so we would turn to sell some. The same happens if people are getting disappointed because MSCI doesn't upgrade when they expected to get upgraded and then the market falls, then we would tend to buy. So, we understand that people are very focused on these things because people know that it matters a lot because the passive world is becoming increasingly important. We just don't follow it. We invest where we think it makes sense for our clients' capital long-term. If irrational movement such as a broker upgrade, downgrades, MSCI announcement, other kind of non-cash flow impact, the other -- that doesn't impact the dividend stream we expect to get in the long run impacts the valuation, then we would tend to go against the flow, and that's the nature of our business: buying great companies when they get cheap, we buy more; when they get expensive, we sell.

Ben Jones - Now, I mean, one other -- you know that's going to be near and dear to our listeners' hearts here in the U.S. is Trump did get elected here in the United States, and one of his big promises was this Trump wall if you will, between Mexico and the U.S. Now, whether that really comes to fruition or not and certainly his opinions are having an impact on Mexico, do you think that that is something that should be a concern as you look at Mexico, or is it kind of a non-issue and more hyperbole as you mentioned?

Thomas Vester - I mean, given the trade links between the U.S. and Mexico, I mean clearly that is important, but I think it's also very clear by now that Trump's tactic is that he tends to come out very, very strong and then the stance softens quite a bit down the road. So, I wouldn't be so nervous, and I think what we are seeing is that actually Mexican companies have very much woken up and really, really understood that they need to really think long and hard about the business and really be even more disciplined on capital allocation. So, we've seen a lot of good impacts from it, and then Ben, I think one thing you will see, let's say Trump goes ahead and takes a very, very tough stance on Mexico, I think what you will find is that a lot of other countries will line up to do business with Mexico and actually try to make some good trade deals. So, I'm really finding it hard to understand why it would be so bad for local and Mexican companies what Trump's policy stance is for the long run in the long-term, and then maybe there will be an opportunity if he really comes out with something that is very, very harsh, which I don't think so. Yeah, maybe stocks will fall and the peso will fall, and guess what we will do, then we will buy more.

Emily Larsen - Thomas mentioned the MSCI index becoming more heavily skewed towards China, changing index methodologies came up in episode 25, *Alexa, Investment My Fixed Income*. Given the recent fed announcement, it might be worth re-listening that episode to understand how index construction can impact what your clients may own.

Ben Jones - Emerging markets can play an important role in diversifying your clients' return streams as part of a well-diversified portfolio. However, as an advisor, you need to think about these positions over longer time horizons versus other more developed asset classes, making this very important that you make time to educate your clients about the role and expectations of an emerging market allocation in their portfolios. Looking ahead, Thomas shared with me some of his viewpoints on where things are headed and what the challenges are. I also put forth a question from one of our listeners. Here's what he had to say. The listener asked, you know, it seems that many of the corrections in the emerging market space seem to stem from indebtedness over time and excessive leverage. What are your thoughts on the fiscal health of emerging market countries today?

Thomas Vester - Yeah, I mean, let me first say, Ben, I mean, that is absolutely correct. And I think the best way to think about leverage is that it doesn't matter if you're a country, if you're a company, if you're a household, if you live above your means, sooner or later, it will hunt you down. If I personally every month spent more than I earned, I've got a problem long-term. If I'm a company that constantly spends more than I make in cash flows, it is unsustainable. It is a hugely unsustainable model that we've seen so many companies in this world today spending so much more in buybacks than they make, so they borrow money to buy back their own stock, it is simply not sustainable. One can argue that it's a clear consequence of in a world where money is free, I actually agree with that argument, but it's unsustainable. Then coming to countries, the same thing goes. If you spent more than you make, you've got a problem. You can spend more than you make in the short-run if you're making good investments. If you're making investments that will pay back in the future, yeah, then you can spend more. But if you spent more than you make for a substantial period, Ben, exactly as the listener is pointing out, then you will run into excessive leverage, and that is the problem. Then you can't pay it back, and then you will have to default. And what all studies show is that countries that defaulting tend to default again. So, what you have got to be careful with when you invest is that you're not too overly exposed to countries that is running an unsustainable household, they are overly leveraged. You've got to be very careful with that because that can impair your capital for the long-term.

Ben Jones - And so as you look into your crystal ball or dust off your crystal ball for the future, are there any kind of global issues or possibilities that keep you up at night when you think about your clients and your portfolio?

Thomas Vester - Yeah, I mean, I still think -- I mean, from an emerging market point of view, one definitely still needs to monitor the debt situation in China. It seems to have improved a bit, but it's something to watch, keep a close eye on. The situation in Africa has gotten a lot better over the past 12 to 18 months. There was a period, again, a consequence of a world where money is for free, there was a lot of bonds issued to African countries where someone like us was spending a lot of time there really strongly questioned why would you lend those money out and would they ever be repaid. That has gotten improved a little bit, but I would say still the biggest worry in an EM context would be the Chinese debt, and then I would have to say, Ben, I mean the problem right now in emerging markets is not emerging markets. That is actually developed markets. There's some very big concerns, rightfully, about what is actually the long-term policy moves in the U.S. and what is the future for Europe, something that if some of these things really go bad, will have very significant consequences for emerging markets but there is again because leverage is so cheap, there is a lot of debt being piled up in the U.S. and in Europe, something to be concerned about. Does the euro really have a future? Will we go back to French franc and Deutsche mark, etc? That is also something that will cause a lot of trouble. And then I think the other thing really to watch out for Ben, and this is probably the biggest worry is actually political -- geopolitical stability in this world where it seems to me if I look over the past five years, since Lehman, we actually have been stepping backwards. The tone is getting worse. People are more flexing their muscles. We've started to ramp up military again, and I'm sorry to point it out but it's actually something that is very familiar to what we saw after the Great Depression. There, because of central bank policy moves were a lot slower and a lot less, what can I say, bold or maybe experimental is the right word. The crisis was a lot more severe, a lot quicker, and that led up to a very, very dark moment in our global history, the World War II. The pattern hasn't been as bad here, but we have seen a very long recession. A lot of people don't feel even though that we're saying we're in a multi-year bull market, a lot of people, common people, just having a job, doing the job, getting a paycheck, don't really feel that this crisis ever ended, so there's a lot of frustration. It came to the expression -- in the U.S. election, it came to expression in the Brexit vote, and then coming to expression in tensions among Russia and its neighbors, potentially China, against the U.S., and it's something to deeply follow very closely, and it's something that definitely worries me both as an investor, Ben, and as a family father.

Ben Jones - Yeah, that's a great point. Now, Thomas, as you think about risk, one thing that was really interesting to me is, back in March, you wrote a paper on the topic of risk measurements in EM portfolios, and I real liked that you kind of took a bold position and argued that standard deviation really isn't an appropriate measure of risk. It's almost too simplistic for these types of markets, and could you expand on that thought process a little bit?

Thomas Vester - Yeah, absolutely. I mean, again, it comes back to what do you actually want when you invest your money? We all want a great long-term return, but on top of that, what we really want as investors, I don't really care what the standard deviation is on my investment, what I care about is, how much is it going to grow long-term in hard currency after costs? Secondly, how much is it going to drop? I don't like to come and open my own investment spreadsheet after a holiday and see that now I lost 20% on this investment. I prefer it to drop as little as possible when markets drop, and so that's how we think about risk. A lot of people talk about tracking error, Ben. We can't spend to tracking error here. We couldn't care less how much we deviate to the benchmark. Then you're right, we talk about standard deviation. What does standard deviation really mean? It talks about the volatility. I don't care about volatility, Ben, as long as the return is up. I don't care that my investment is more volatile than the market as long as it does very well. What I care about is that it shouldn't drop too much in hard currency because I rely on this investment. I rely on this investment for my retirement, for my kids' college tuition fees. Therefore, I don't want to see it going down. That's how we think about risk.

Ben Jones - Yeah, and I really like that analogy because you talk about volatility, well there's good volatility and bad volatility. I think that's a reason that measures like the Sortino Ratio and other things have become much more popular over the last decade. One of the things I found most interesting is that you talked about business risk. You said that staying in business, business risk is the risk that the business will be sustainable and durable over the long-term. That accounts for about 75% of returns if you get five years and out in a portfolio, which was really interesting to me. But business risk seems pretty hard to define. It seems a bit nuanced. Could you give me maybe an example of how you can kind of tangibly assess the business risk of a company?

Thomas Vester - No, I mean, business risk. I mean the best way to think about it, Ben, is if you were to buy a company yourself, you want to make sure that if you were to invest everything you own into a startup or into a business, you're going to buy a business in the market. I don't know what your net wealth is Ben, but let's just say that you have for some reason made a very good fortune throughout your career or you have inherited a lot of money, so you've got $20M in the bank. Then you're saying, I want to buy one company with all this money. Then what really matters, Ben, to you is whether or not you are investing in a company that will do well in the future. Because you want a company that will continue to generate cash flow 10 or 20 years from now. When we make investments, Ben, we're doing it for the long run. So we want to make sure that the investments we make are in companies that have a viable business model for the long run. I couldn't care less if I'm invested let's say, I invest in Facebook because I believe that it will have more users in the next quarter, so the share price will go up 20% because analyst estimates it too low, and then I will sell it. That's not how we operate. We want to be invested in companies where we can see the future, where we can see the product they sell is something that still will be in demand. We are confident about competition so that we'll maintain the market share. It is run by a management team that know how to treat the cash flow how they generate with respect, so they go out and make solid business acquisitions where they can, but also refrain from that, and then they send the rest out in dividends. We are minority shareholders, so we want to be with a majority shareholder who respects minorities fairly and respects that if he owns 60% of the company, he should also has 60% of the cash flow, the rest should go to the minorities. That is business risk to us. It's about finding companies that will be around for the long run. Something that, let's say, Warren Buffet, Charlie Munger have been very good at looking for the long run. It's the same we're doing in emerging markets, Ben. We don't care about the companies having a few clients in the rice in the short run. In fact, sometimes we like it because that is why we might be able to make a very good buy, a very good valuation because people are scared. But what we do not like is to see that it's a very big threat to our business in the long run. So we're very careful with that. So one example, Ben, I could give you would let's say we're cautious with some retailers because we are nervous what the impact of let's say an Amazon, etcetera is doing to that space. So we are careful with some retail investments. That doesn't mean we would not make them, but we're just very, very careful. But it definitely don't mean that we would go out and buy the etailers because we think some of the valuations are absolutely absurd. We would never pay that kind of money for the investment because again, we're here to make a return in the long run. If everything is reflected in the share price, you might never make a good investment irrespective of how much the company grows.

Ben Jones - Wonderful. Well I think some of my friends and family that might be listening might be sorely disappointed to find out I don't have $20M to buy a company with, but I do think that your example is a really good example of making sure that the durability of that company can sustain those advantages over time. You point out the tech fueled world like Amazon affecting retailers; it makes a lot of sense. I'm curious about why economies of scale aren't impacting some of the consumer names in your portfolio. So I think of the milk example you used earlier, it seems to me that there's a winner take all mentality in the developed worlds. How come those companies aren't able to move into some of these emerging markets and squeeze out these smaller domestic players?

Thomas Vester - Oh, but I mean, I mean, I mean there is scale advantage Ben, and when you look in our portfolios you will see that the vast majority of the companies we invest in are market leaders. They are owning their markets. But the beautiful thing about many of the companies we invested in is that many of these brands are very local. So, you can come in as a U.S. firm and say, now I want to conquer this market, but it often doesn't work out because there's a very strong brand loyalty. So you've got to invest in companies with a strong brand. A brand that the consumers want. You should never invest in the company where the consumer wanted your product just because there's no other offering, because that will come. You've got to invest in companies where the consumer wants your product because it's a great product and they love your brand. Then they can be a local brand and it can be a global brand. You will find when you look at our portfolios, Ben, that yeah, we invested sometimes in some subsidiary of let's say, Nestle, Unilever, in the Heineken because they are greatly recognized brands and we can make some great investments with co-invest with these global brands into these local markets. But there's also a whole range of great local brands that the consumer really, really asks for day in and day out because they love them and they've grown up with them and they will continue to consume them no matter how much the global companies pushes in with their brand. Then it becomes a very, very sustainable proposition. Then there's also the angle, Ben, that often we found our self where we own a company and then a big multi-national comes in and say, I want to buy it. Then yeah, if the price is good enough, we might sell our shares.

Ben Jones - Interesting. Now I want to circle back to something that you said earlier, which I've always found really interesting about the way you think of the world. You mentioned that you think of the world in 5 and 10-year time horizons, which is a fairly long-term time horizon. For most of our listeners who are thinking about this, they probably think of funds in three-year performance or five-year performance numbers. It feels like a long investment period. When people think about your portfolios, should they think about it kind of like they would private equity? The long holds because there's big jay curves? Or how can you explain some of the thinking there around that time horizon?

Thomas Vester - Yeah, I mean first of all, Ben, in a world that is becoming increasingly short-term, I only think it makes sense to become even more long-term. The value, there's a tremendous value of being long-term in this world. But the true reason why we are long-term is that we simply just match it with our clients. Our clients are long-term investors. Clients who want to see their retirement funds grow, they want to see their family fortune grow for the next generation. It might be funds invested for endowments. So these endowments can finance more scholarships in the future. That's the kind of clients we have. When we ask our clients, what is it you actually want to achieve? Our clients want to see their money grow in the long-term and want to see when they look, allocate capital to us, when they look in 5, 10, 15 years, seeing that they have gotten a significant better return after cost than if they invested in the benchmark or with our average competitor. And that's what we're here for them, that is to honor that obligation and keep a focus on the long-term and honor their trust. They have trusted us with their capital to go out and make a great long-term return for our clients. So it's really coming down to that, matching the duration with our clients' horizon. And then also, we are in a world that is so short-term. So the benefit of being long-term is probably better than it's ever been in this world, Ben.

Emily Larsen - That's an interesting point and a chilling thought. When we think about the future of the world and the global economy. But as Thomas keeps returning to, it's the long-term that matters most.

Thomas Vester - There's a great long-term prospect in emerging markets and frontier markets. You've got to take a long-term view. Then you've got to be rational and investment principles are universal. They're no difference whether or not you invest in the U.S. or in China or in Brazil or in Russia. So take that long-term view and the short-term is very hard to predict. Markets might very well take a very deep dive at some point because we have seen a lot of years of good equity returns. The other thing is that when you invest as differently as we are at LGM Investments to a benchmark and to the competition, yeah, we might look very silly from a time period. We have no problem with that. But we just want to make sure that our clients understand this and understand that what we are here to deliver is great long-term returns. We can't promise what is going to happen in the short run.

Ben Jones - Thomas, thanks for your enthusiasm and expertise on the subject today. And to our listeners, thank you for taking the time to listen. Be sure to check out the links and resources to this episode at BMOGAM.com/betterconversations. Thanks for listening to Better conversations. Better outcomes. This podcast is presented by BMO Global Asset Management. To learn more about what BMO can do for you, visit us at www.bmogam.com/betterconversations.

Emily Larsen - We value listener feedback and would love to hear about what you have thought about today's episode. Or, if you're willing to share your own experiences or insights related to today's topic, please e-mail us at betterconversations@bmo.com. And of course, the greatest compliment of all is if you tell your friends and co-workers to subscribe to the show. You can subscribe to our show on iTunes, Google Play, the Stitcher app, or your favorite podcast platform. Until next time, I'm Emily Larson.

Ben Jones - And I'm Ben Jones. From all of us at BMO Global Asset Management hoping you have a productive and wonderful week.

Emily Larsen - This show is supported by a talented team of dedicated professionals at BMO, including Pat Bordak, Gayle Gipson and Matt Perry. The show is edited and produced by the team at Freedom Podcasting, specifically Jonah Geil-Neufeld and Annie Fassler.
Investing internationally, especially emerging markets, involves additional risks such as currency, political, accounting, economic, and market risk.

presentation may contain forward-looking statements. Investors are cautioned not to place undue reliance on such statements, as actual results could vary. This presentation is for general information purposes only and does not constitute investment advice and is not intended as an endorsement of any specific investment product or service. Individual investors should consult with an investment professional about their personal situation. Past performance is not indicative of future results. BMO Asset Management Corp is the investment advisor to the BMO funds. BMO Investment Distributors LLC is the distributor. Member FINRA/SIPC. BMO Asset Management Corp and BMO Investment Distributors are affiliated companies. Further information can be found at www.bmo.com.

C11: 6171399