

# Does your international shares allocation lack emerging markets flavour?



# What is the Trust's investment objective?

The Legg Mason Emerging Market Trust seeks to outperform its benchmark<sup>1</sup> over rolling three year periods.



## Experience matters

Esemplia Emerging Markets Limited (Esemplia) is the fund manager of the Trust and has been managing emerging markets equity portfolios for over 18 years.

The investment team has a long track record of investing in the emerging markets and has participated in these markets during times when there have been significant financial events.

## Broad 'core' coverage

The Trust is broadly diversified across different emerging market countries and industries. With investments in around 100 stocks, the Trust is ideally suited to investors seeking a core, well diversified exposure in emerging markets to complement their existing international equities investments.

## Investment innovation

As a specialist investment manager, Esemplia's investment process has evolved to suit the changing structure of emerging markets. The incentive for continual innovation in its investment techniques stems from the fact that investing in emerging markets represents a key aspect of the business model.

When Esemplia commenced operations in 1991, its investment process was developed around country 'top-down' themes.

Today, the specialist fund manager applies a multi-lateral approach that includes bottom-up stock specific factors, industry drivers and other more sophisticated excess return (or 'alpha') sources of performance.

## Critical cell risk management – built for volatile conditions

The emerging markets asset class is characteristically volatile. Risk management is one aspect of Esemplia's investment process that has been custom-built for emerging market conditions.

Esemplia applies a 'critical cell' view of the emerging markets landscape, whereby the investible universe is broken down and categorised into separate country and industry buckets, or cells. Each cell that represents over 1% of the benchmark (either by country or industry measure) is defined as critical.

In the next step of the investment process, each cell is populated with the companies that are the most highly rated 'best ideas' by Esemplia's team of analysts.

The 'best ideas' portfolio is adjusted for risk management purposes and to ensure each critical cell is represented.

The critical cell approach ensures broad coverage of industries and countries across the portfolio while helping to diversify risk.

## Multi-cultural advantage

In emerging markets, sound investment decisions need the support of first-hand knowledge of country-specific factors such as political environments, accounting practices and other cultural factors. Esemplia's investment team includes 16 different nationalities and a significant proportion of members who have on-the-ground life experience in emerging market countries, either through birth or previous employment.

# Why include emerging markets in your portfolio?

## Economic growth potential

The emerging markets include some of the fastest growing economies in the world. The International Monetary Fund<sup>2</sup> (IMF) predicts that in 2010, economic growth in emerging and developing markets (5.1%) will exceed that in developed markets (1.3%). China and India, two powerhouses of the emerging markets, were identified by the IMF as the main drivers of world economic growth. With 80% of the world's population living in emerging market countries, the prospects for future economic growth in these regions is supported on two fronts: production potential - with access to relatively cheap labour and raw materials - and; the significant consumer market - with increasing evidence that the 'middle class' workers in some key emerging markets are becoming wealthier and potentially spending more.

While the favourable economic outlook helps support the case for a long term investment in emerging markets, other factors help define the potential portfolio benefits that this unique asset class can provide.

## Higher performance potential

An allocation to emerging markets (as part of an international equities portfolio) can potentially increase returns. As an asset class, emerging markets has a higher risk and return profile compared to 'developed market' equities, as shown in the chart. While volatility is higher in the short term, over the five-year period emerging markets have outperformed their developed market counterparts.

Emerging markets, investment returns can vary significantly each year. However, where economies are in a long-term strong growth environment, there is potential for those companies in economies that are well-managed to increase earnings and shareholder returns through the investment cycle.

**Emerging Markets versus Developed Markets Indices  
5 years to April 2010**



\* Past performance is no indication of future performance. Source: Legg Mason

## Structural improvements

Many of the issues that contributed to past turbulence in emerging markets have been identified and are continually being addressed through improvements at both the corporate and country level. Most emerging market countries are now structurally and fundamentally more sound than in the past. Generally, companies are displaying more discipline in the way they allocate capital and seek to maximise shareholder returns. This has resulted in significant improvements in capital returns and profitability.

## Diversification benefits

Through the business cycle, there are times when the equity performance of emerging markets can deviate significantly from developed markets. Given the potential for periods of low correlation between these markets, portfolios can benefit from the inclusion of a dedicated allocation to emerging markets.

## Trust details

### Benchmark<sup>1</sup>

MSCI Emerging Markets Index expressed in Australian dollars.

### Target Tracking Error Range

5%-8%

### Target Investors

Investors with international equities exposure who wish to access emerging markets through a specialised vehicle

### Stock portfolio limits

Benchmark + 2.5%

### Industry sector limits

Benchmark +/- 8%

### Country limits

Benchmark +/- 5%

### Gearing

Nil

### Hedging policy

100% unhedged

### Rating

★★★ 3 Star S&P Rated<sup>3</sup>

## Investment process overview

The investment strategy follows a disciplined and systematic process which places emphasis on analysing 'bottom up' (security) factors and integrating those factors with 'top down' (country) insights. Esemplia has a well-resourced investment team structured logically into portfolio management, country strategy and stock research teams.

Portfolio managers validate inputs, make final portfolio decisions and are overall accountable for the performance of the Trust. Supporting the portfolio management team are country strategists and stock research analysts.

Country strategists are responsible for anticipating shifts in country risk premiums. This is particularly important given that country risk has a significant impact on equity (stock) markets in emerging economies.

Stock research analysts are organised along industry lines and are responsible for identifying the most attractively valued companies in the investment universe.

## Who is Esemplia?

Esemplia is part of the global Legg Mason, Inc. group. Esemplia is a dedicated emerging market equities asset manager established in 1991. Legg Mason has appointed Esemplia as the fund manager for the Legg Mason Emerging Market Trust.

## Further Information

Please contact Legg Mason on freecall 1800 679 541 or visit our website at [www.leggmason.com.au](http://www.leggmason.com.au)

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<sup>2</sup> International Monetary Fund 'World Economic Outlook' October 2009.

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