

# The Right Balance: Size Exposure in Emerging Markets

> MARCH 2012  
NEWSLETTER

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China – a country of about 1.3 billion people – has only 147 airports for civilian use. In contrast, the United States has 5,000 airports with paved runways, and 376 with regularly-scheduled passenger service. Beijing, increasingly known for frustrating road congestion, has only one airport. Indonesia, Turkey, India, and Brazil all need more infrastructure and other fixed investment, manufacturing facilities and distribution, logistics services, energy-related facilities, roads/highways/bridges/ports, etc. How does an investor get direct exposure to such rapid economic development?

In Causeway's Emerging Markets Fund, we don't sit in the traffic jams and clogged airports; we invest in their expansion. Now, at the Fund's fifth anniversary, we decided to take a closer look at the local component of emerging markets equities. What is the "pure" emerging markets exposure of the Fund at present? How do we access indigenous economic expansion and resulting earnings growth? When investing in such swiftly transforming economies, can we avoid concentrations that may go awry?

We spoke to Causeway quantitative portfolio managers, Arjun Jayaraman and MacDuff Kuhnert, as well as senior analyst, Joe Gubler, for their perspectives.

## **How does Causeway access local growth in its Emerging Markets Fund?**

DK: We achieve significant exposure to developing economies through stock selection. Although we constrain our sector and country weights to the MSCI Emerging Markets Index ("the Index") to ensure diversification, we give ourselves considerably more freedom in stock selection. We can hold meaningful weights in smaller companies whose fortunes are directly tied to local, rapidly growing economies, despite their modest representation in the Index. These lower market

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### CONTACT INFORMATION

#### *Sales and marketing*

**Mark Cone**

email: [cone@causewaycap.com](mailto:cone@causewaycap.com)

phone: 310-231-6108

#### *Client service*

**Eric Crabtree**

email: [crabtree@causewaycap.com](mailto:crabtree@causewaycap.com)

phone: 310-231-6145

# The Right Balance: Size Exposure in Emerging Markets

**Causeway's Emerging Markets Fund has significantly more economic exposure to emerging markets than the Index, particularly from domestic-focused companies.**

capitalization stocks have contributed nearly half of the excess return of the Fund since inception, despite averaging closer to quarter of the Fund's weight.

**If some stocks listed in emerging markets have more local exposure than others, how do you determine the economic composition of your portfolio?**

JG: A company's country of listing often provides an incomplete understanding of its true economic exposure by geography. We look carefully at where a company generates its revenues. We've analyzed our holdings from several different angles, and found that smaller companies have more local sales and are more closely tied to their local economies. Generally, these small-to-mid-size businesses generate earnings growth at a rate in excess of their more global-oriented, larger peers. Causeway's Emerging Markets Fund has significantly more economic exposure to emerging markets than the Index, particularly from these domestic-focused companies.

**Arjun, what are some examples of companies geared into fast-growing local economies?**

AJ: We find candidates across the emerging markets landscape, in almost every country. Currently, the portfolio holds a Chinese cement producer that benefits from ongoing investment in domestic construction, including government-subsidized housing. We own shares of an industrial conglomerate in Indonesia; a country whose infrastructure spending is just beginning to catch up to peers, after years of under-investment. One of our Korean holdings is the dominant manufacturer of the essential seasonings, sweeteners, and fermenters of the Korean diet. Our holding in a Thai operator of petroleum refineries and gas service stations is well-positioned to benefit from increasing energy demands in the wake of Thailand's burgeoning technology sector and subsequent industrialization. We own shares of a Turkish company that manufactures and sells tractors. As Turkey's agriculture industry evolves to feed the nation's growing population, demand for the company's equipment should strengthen.

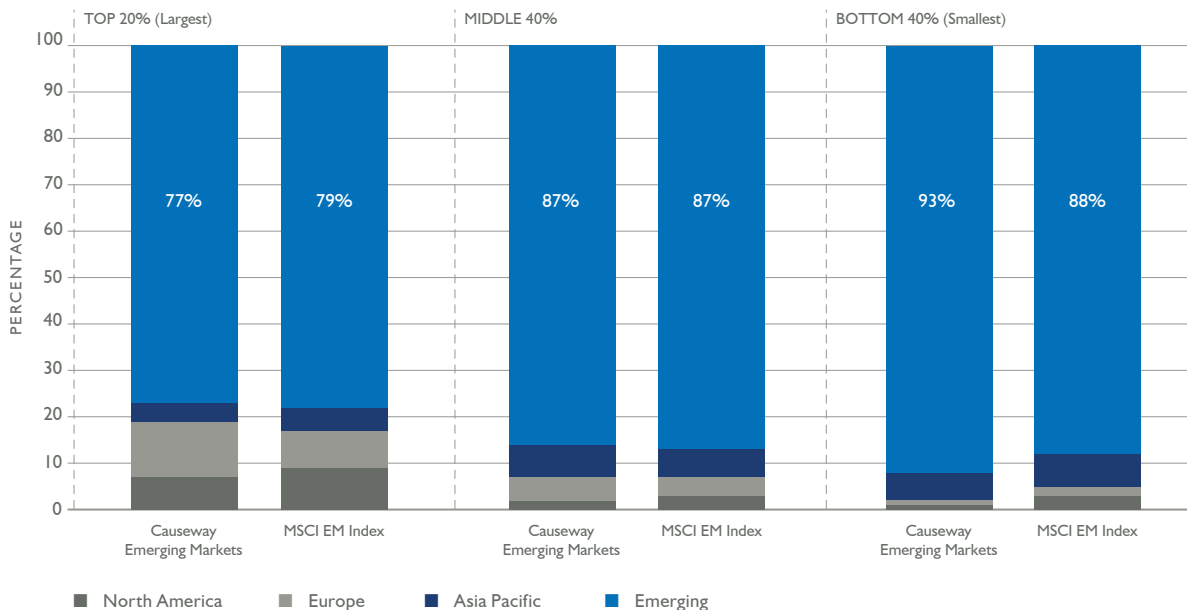
**How are these more supercharged companies weighted in the Fund versus larger, more geographically diversified stocks? Why not hold an even greater weight in the smaller companies if they have such attractive upside potential?**

## CAUSEWAY EMERGING MARKETS FUND COUNTRY ALLOCATION AS OF 1/31/2012

EMERGING EUROPE, MIDDLE EAST, AFRICA	FUND (%)	MSCI EM INDEX (%)
Czech Republic	0.0	0.3
Egypt	0.0	0.3
Hungary	0.0	0.3
Morocco	0.0	0.1
Poland	2.9	1.4
Qatar	0.3	0.0
Russia	7.7	6.5
South Africa	5.7	7.6
Turkey	3.8	1.3
United Arab Emirates	0.3	0.0
	<b>20.7</b>	<b>18.0</b>
<b>EMERGING LATIN AMERICA</b>	<b>FUND (%)</b>	<b>MSCI EM INDEX (%)</b>
Brazil	13.3	15.4
Chile	0.5	1.7
Colombia	0.0	0.9
Mexico	2.0	4.5
Peru	0.0	0.7
	<b>15.9</b>	<b>23.3</b>
<b>EMERGING ASIA</b>	<b>FUND (%)</b>	<b>MSCI EM INDEX (%)</b>
China	20.0	17.8
India	5.6	6.7
Indonesia	4.0	2.8
Malaysia	2.6	3.3
Philippines	0.0	0.7
South Korea	16.1	14.8
Taiwan	10.0	10.7
Thailand	4.0	1.9
	<b>62.3</b>	<b>58.8</b>
<b>MULTI REGION EMERGING</b>	<b>FUND (%)</b>	<b>MSCI EM INDEX (%)</b>
Multi-National Emerging	0.3	0.0
	<b>0.3</b>	<b>0.0</b>
<b>SUBTOTAL</b>	<b>99.2</b>	<b>100.0</b>
<b>CASH</b>	<b>0.8</b>	<b>-</b>
<b>TOTAL</b>	<b>100.0</b>	<b>100.0</b>

JG: These smaller-cap stocks tend to be risky in high concentrations, so we use size diversification to mitigate volatility. Keep in mind that Causeway manages its emerging markets portfolio using a quantitative investment process. Other than having our fundamental research team review the portfolio, the bulk of our process is model-driven. We construct the portfolio using a quantitative methodology, where currently bottom-up (stock-specific) criteria have a 75% weight and top-down (macroeconomic) criteria carry a 25% weight. We place considerable emphasis on a company's specific valuation characteristics and factors indicating superior earnings growth.

## GEOGRAPHIC REVENUE EXPOSURE, BY MARKET CAPITALIZATION SEGMENT AS OF 1/31/2012



Sources: FactSet, Bloomberg, Causeway Analytics. Causeway estimates are based on latest available revenues reported by companies in the portfolio on 1/31/12, proportionate to holding weights. Israel is classified as an emerging country.

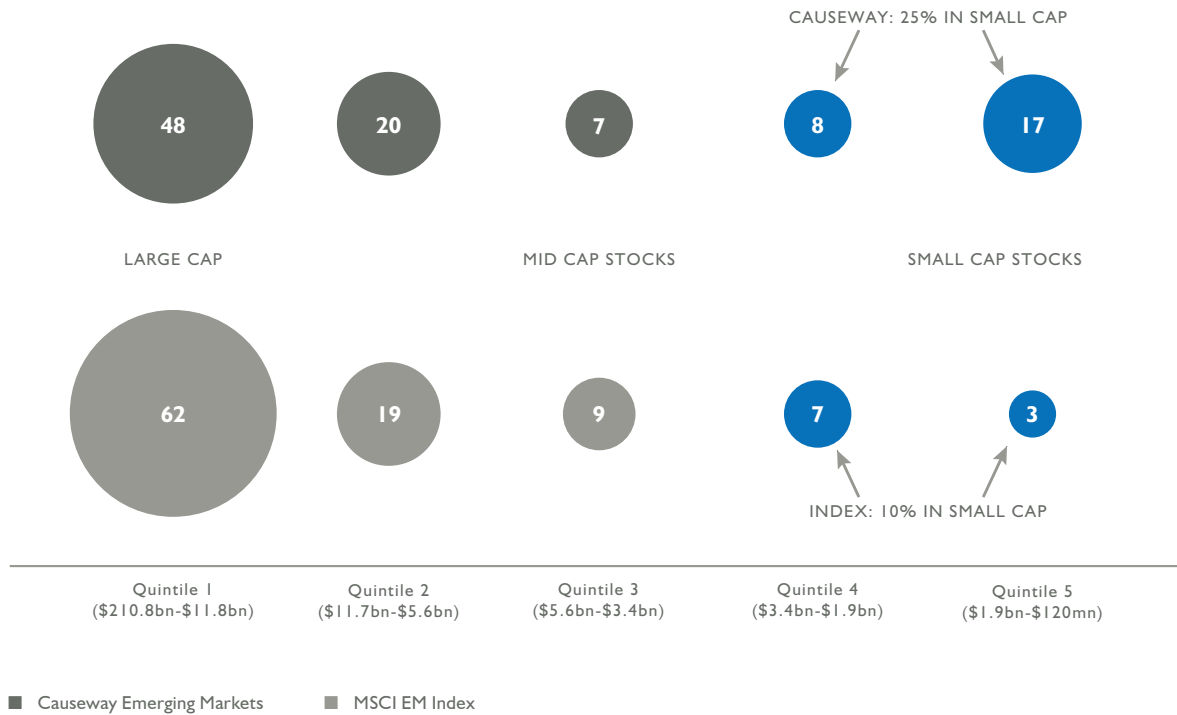
DK: Because of the risk controls in our process, we've been able to construct a portfolio with volatility similar to the Index, despite the fact that we include a larger share of small-cap stocks. Being able to exploit the entire universe of opportunities in emerging markets is a key benefit of our strategy.

### *As your Emerging Markets Fund assets grow, how will you retain meaningful access to these smaller cap stocks?*

DK: We see no end to the number of investment opportunities in the local emerging market economies. As profits expand for the companies satisfying local demand, new entrants will emerge—and likely raise equity capital. This will replenish our supply of small-to-mid cap stocks with enviable earnings growth potential.

AJ: As long as we can find undervaluation and competitive upside potential in these more indigenous emerging markets companies compared to the exporting giants, the Fund will maintain this layer of diversification – by size and geography—to support performance. We believe that's a formula for superior risk-adjusted return.

## EMERGING MARKETS EQUITY EXPOSURE BY MARKET CAPITALIZATION AS OF 1/31/2012



Source: FactSet

## Causeway Emerging Markets Fund Highlights

### Philosophy

- Actively managed, tracking-error oriented, quantitative emerging markets strategy
- Combines bottom-up and top down factors in security selection
- Risk control
  - Constrain country/sector weights versus benchmark
  - Use proprietary quantitative tools

### Process Highlights

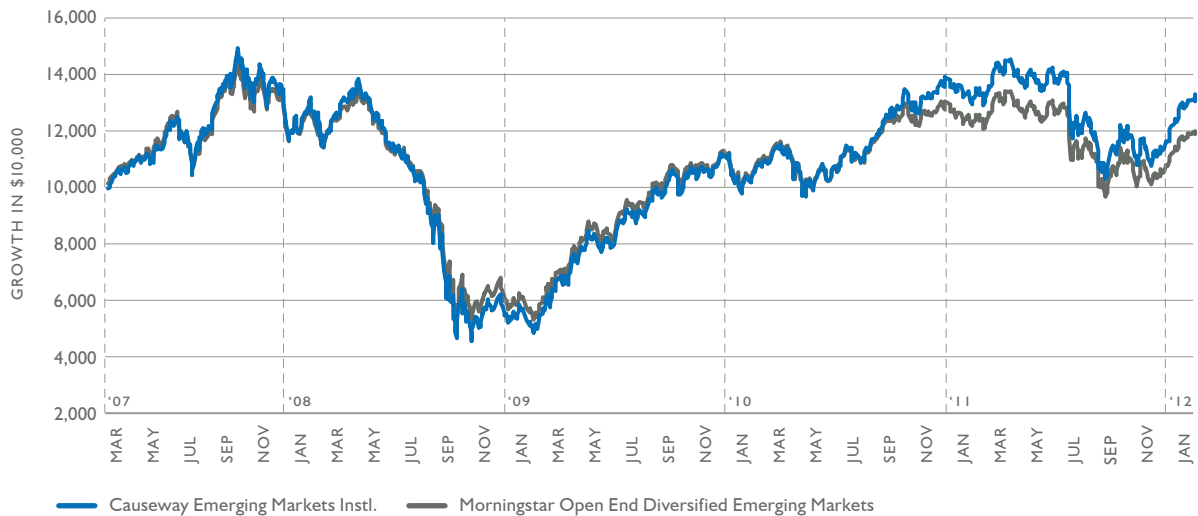
- 24 emerging markets
- 1,200 stock universe
- Employ stock ranking and risk models designed for emerging markets
- Use optimization to maximize expected return per unit of risk

### Portfolio Managers

- Arjun Jayaraman, MacDuff Kuhnert

# Causeway Emerging Markets Fund

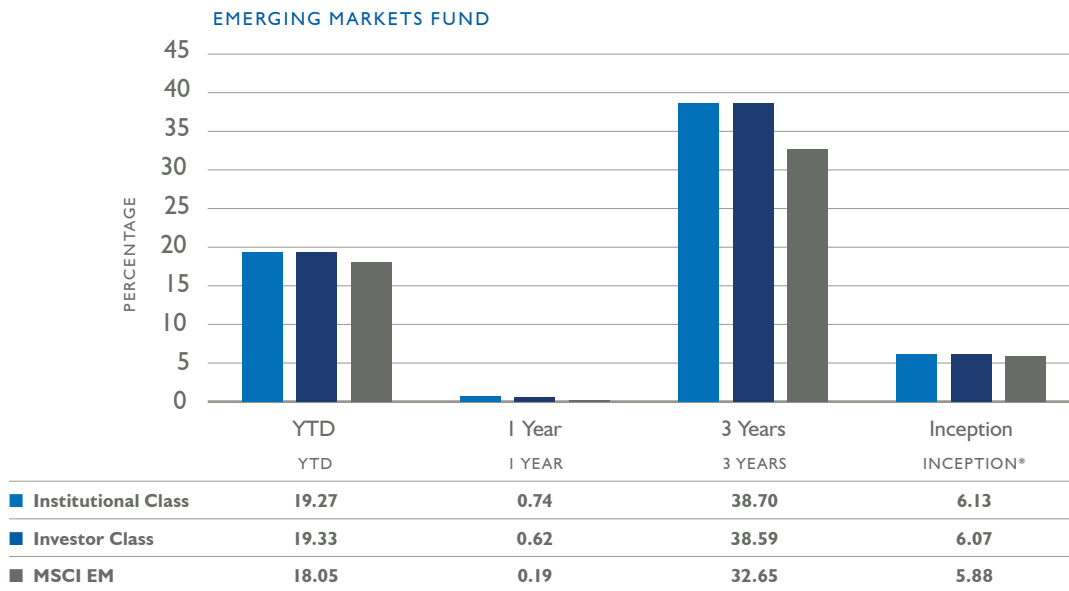
**CAUSEWAY EMERGING MARKETS FUND HAS OUTPERFORMED PEERS SINCE INCEPTION**  
FROM 03/29/07-02/29/12



Source: Morningstar

## PERFORMANCE (as of 2/29/2012)

Annualized for periods greater than one year



## PRIOR QUARTER PERFORMANCE (as of 12/31/2011)

	1 YEAR	3 YEARS	INCEPTION*
<b>Institutional Class</b>	-18.11	24.83	2.49
<b>Investor Class</b>	-18.24	24.66	2.41
<b>MSCI EM (Gross)</b>	-18.17	20.42	2.45

\*Inception: March 29, 2007

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth less than their original cost and current performance may be lower than the performance quoted. Returns greater than one year are average annual total returns. Total returns assume reinvestment of dividends and capital gains distributions at net asset value when paid. All information is as of the date shown. Investment performance reflects fee waivers in effect. In the absence of such fee waivers, total return would be reduced. Contractual fee waivers are in effect until 1/31/13. The expense ratios for Institutional Class shares are 1.60% and 1.36% after adviser fee waiver. The expense ratios for Investor Class shares is 1.79% and 1.56% after adviser fee waiver.

### **Important Disclosures**

The market commentary expresses the portfolio managers' views as of 02/29/2012 and should not be relied on as research or investment advice regarding any stock. These views and portfolio holdings and characteristics are subject to change. There is no guarantee that any forecasts made will come to pass. Any portfolio securities identified and described do not represent all of the securities purchased, sold, or recommended for client accounts. The reader should not assume that an investment in the securities identified was or will be profitable.

Investing involves risk including loss of principal. In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Diversification does not prevent all investment losses.

**To determine if a Fund is an appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund's prospectus, which may be viewed and downloaded by clicking [here](#) or by calling 1-866-947-7000. Read it carefully before investing.**

*The Causeway Funds are distributed by SEI Investments Distribution Co. (SIDCO). SIDCO is not affiliated with Causeway Capital Management LLC.*