Designed for Alpha: Causeway's Emerging Markets Allocation Model

July 2025

Allocating across emerging and developed markets is inherently complex. Investors must navigate differences in risk and return profiles and deep structural and macroeconomic divergences that evolve over time. Without a disciplined, data-driven process, these variables are easy to overlook—and difficult to time.

Since 2007, Causeway has employed a proprietary, data-driven allocation model within our International Opportunities strategy to assess the relative attractiveness of Emerging Markets (EM) and Developed Markets (DM). This disciplined, quantitative approach is designed to complement the strategy's stock selection by integrating signals spanning valuation, business quality, earnings trends, macroeconomic conditions, and investor sentiment.

We designed our allocation model to be scalable, so its active weight recommendations can better align with investors' preferred magnitudes of active Emerging Markets exposure. For the International Opportunities strategy, we have kept our dynamic Emerging Markets exposure within a relatively narrow band, ±4% of the EM weight in the MSCI ACWI ex USA Index. Even within this modest range, the EM allocation alone has contributed a cumulative 3.9% to gross alpha for the strategy since its inception on June 30, 2007. An information ratio of 1.3 underscores the model's ability to generate meaningful excess returns while maintaining disciplined benchmark-relative risk.

Causeway's EM Allocation Model: Proven Track Record of Value-Added

Cumulative EM Allocation Effect of a Causeway International Opportunities Representative Account from Inception (June 2007) – June 2025
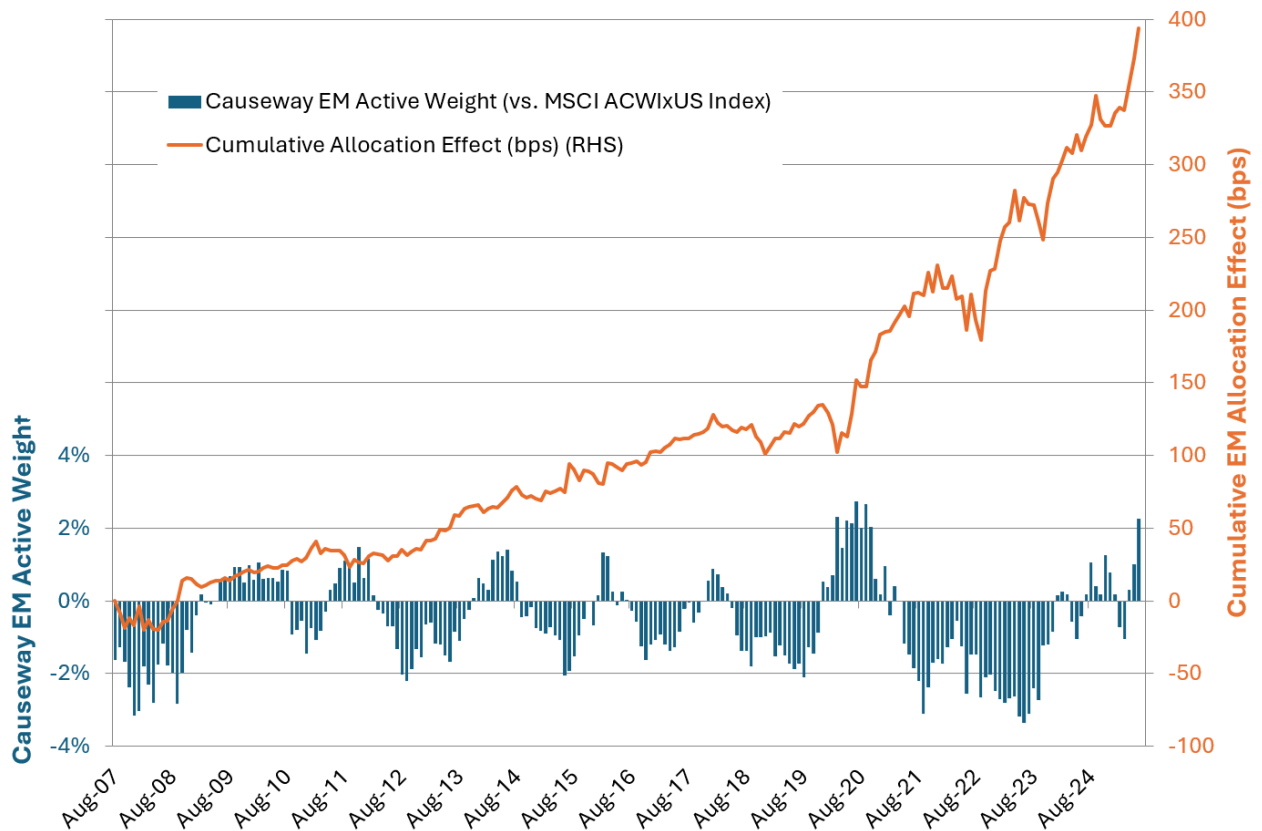
Source: FactSet, MSCI, Causeway. The allocation effect is calculated as the difference in total return between the representative account's DM/EM allocation and that of the benchmark. In each case, the total return is calculated by adding (the product of the DM percentage exposure and the return of the MSCI World ex-US Index) to (the product of the EM percentage exposure and the return of the MSCI Emerging Markets Index). Allocation Effect and Active Weight do not include or reflect cash held in the representative account.

Why we use a dynamic allocation model for Emerging Markets
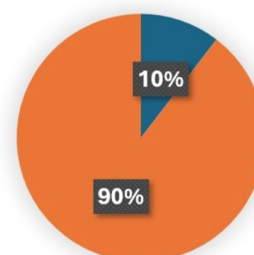
- **Relative value shifts:** Valuation remains a key driver of long-term returns, even in growth-oriented markets. EM has historically traded at a discount to DM, but that gap has fluctuated with sentiment, macroeconomic conditions, politics, and structural shifts. As EM transitions toward higher-value sectors, our **valuation approach** incorporates multiple historical time frames—5-, 10-, and 20-year—to account for structural change.
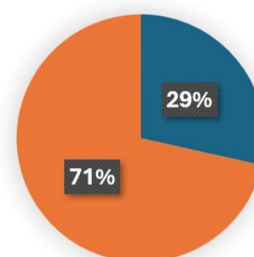
- **Evolving corporate fundamentals:** Improvements in corporate governance, profitability, and capital discipline across many EM markets are reshaping the asset class. Our **quality analysis** tracks these shifts using 5-, 10-, and 20-year relative comparisons, which is designed to capture both cyclicality and long-term evolution in EM fundamentals.

- **Earnings-driven capital flows:** Near-term earnings momentum and analyst sentiment can materially influence EM asset flows. Our **earnings growth factor** category aims to integrate these signals. We are generally willing to pay a higher multiple for an EM company with positive sentiment and earnings catalysts.

- **Overall superior long-term growth potential:** EM often offers stronger long-term growth, led by shifts toward innovation-led development in countries like China, India, and Brazil. Others remain commodity- and manufacturing-driven, which we monitor through indicators like the OECD Composite Leading Indicators (CLI). EM performance is typically more sensitive to currency and liquidity trends—strengthening currencies, falling rates, and a weaker USD—factors we incorporate into our **macroeconomic analysis**.

- **Higher risk sensitivity:** EM volatility tends to exceed DM and emerging markets often are the first to react when global sentiment shifts. We deploy a **contrarian risk aversion** approach, favoring EM when investor risk aversion is high. We are cautious when markets become complacent, as EM is typically most exposed to sudden disruptions.

Model Framework: Five Key Factor Categories

Factor Category	Representative Metrics
Valuation	Book-to-price, earnings-to-price

Quality	Return on equity, profit margins, historical growth consistency
Earnings Growth	Up/down earnings revision ratios (float- and equal-weighted)
Macroeconomic	Interest rates, USD movement, gross domestic product growth, OECD CLI
Risk Aversion	VIX, VXEEM, EM sovereign spreads, high yield spreads

A Proven, Evolving Advantage

Financial markets are not static—and neither is our EM-DM allocation model. As capital flows, monetary regimes, and global economic structures evolve, so too must our approach. Over time, we've refined our inputs to better reflect the realities of today's investment landscape. For example, we updated our macroeconomic signal to emphasize global liquidity over yield curve shape in a low-growth environment; added high yield bond spreads over US Treasuries to reflect how the Fed responds to changes in financial conditions; and incorporated OECD CLI with the differing drivers of EM and DM growth. These enhancements help the model deliver timely and relevant insights, which we believe leads to more consistent alpha delivery.

By translating top-down signals into actionable allocation decisions, Causeway's proprietary allocation model helps clients, in our view, capture opportunity, manage risk, and adapt to changing global markets. For investors seeking to enhance their global equity exposure, we believe this integrated framework offers a distinct advantage—grounded in evidence, responsive to market shifts, transparent and repeatable.

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The Cboe Volatility Index (VIX) is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX℠) call and put options. The Cboe Emerging Markets Volatility Index (VXEEM) is a VIX-style estimate of the expected 30-day volatility of returns on EEM, an iShares MSCI Emerging Markets ETF that seeks to track the investment results of an index composed of large- and mid-capitalization emerging market equities. Like VIX, VXEEM is calculated by interpolating between two weighted sums of option mid-quote values, in this case options on EEM.

The MSCI ACWI ex-US Index captures large and mid-cap representation across 23 developed markets and 24 emerging markets countries. It is not possible to invest directly in an index.

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