# Portfolio Update: Strategic Allocation Changes

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## Summary


- We are reducing the strategic allocation to emerging-market stocks and increasing the strategic allocation to developed international stocks.
- These changes eliminate the strategic overweight to emerging-market stocks / underweight to developed international stocks and bring the strategic weights more in-line with the MSCI ACWI index (roughly 60% US, 28% Developed International, and 12% Emerging-Markets).
- These trades will be implemented across all portfolios (Active, Index, Alpha-Core, and ESG) and all risk profiles.
- Our tactical equity positioning will not change – we remain overweight emerging-market stocks / underweight U.S. stocks.


## Trade Details

Based on our assessment of the evidence and likely trends, we no longer have conviction that a strategic overweight to emerging-market stocks relative to its global market cap weighting (measured by the MSCI ACWI index) will benefit client portfolios. Therefore, we are reducing the strategic allocation to emerging-market stocks to bring it in-line with the MSCI ACWI. To further align our portfolios with the ACWI index, we are increasing our exposure to developed international stocks.

As background, in February 2012 we introduced a strategic allocation to emerging-market stocks. Our rationale at the time can be summarized by the following points:

- Prior to 2012, our strategic allocations had a large US equity bias (80%) with zero exposure to emerging-market stocks.
- Emerging markets represent a large percentage of the world's population, their economies were rapidly developing and becoming a more significant force in the global economy.
- Given the prospects of better productivity and better demographics, we believed emerging-market economies were likely to grow at a superior rate than developed markets.
- Over time, as their economies and capital markets matured and became more efficient, we believed higher economic growth would translate to higher corporate earnings growth and a materially larger share for EM equity markets as a percentage of the total global equity market cap.

Over the very long-term, we anticipated that emerging-market stocks would generate attractive long-term returns and adding a dedicated strategic allocation to emerging markets would enable us to take advantage of a broader, global, investment opportunity set.

Directionally, our views from 2012 still hold. Most importantly, we still believe the last bullet point to be true: that EM market stocks will generate attractive long-term returns and a dedicated strategic allocation to EM equities enables us to take advantage of this broader investment opportunity set. However, we no longer have conviction that EMs are likely to drive superior long-term *corporate earnings growth* that is necessary to drive superior long-term returns for EM equity market shareholders relative to US and developed international stocks, taking into account EM's higher risk.

Our reduced confidence in the long-term return potential for emerging-market stocks is driven primarily by our view of China. Specifically, the quality, strength, and duration of China's longer-term growth prospects, and hence the expected returns to equity shareholders, has materially deteriorated in our view, to the point where we no longer want to have a long-term strategic overweight to emerging-markets relative to its global equity market allocation, as represented by the MSCI ACWI index.

China's economic, policy, and geopolitical path have changed materially compared to what we expected back in 2012, and even versus what we expected two to three years ago. China is obviously key to emerging-market stocks as it is roughly one-third of the EM equity index and has a huge economic influence on other EM economies.

Note that while we are reducing our strategic exposure (i.e., on a 10 to 20 year time horizon) to emerging-market stocks, we still view them as very attractive on a tactical basis (over the next 3 to 5 years) given their attractive valuations and potential for a strong earnings recovery. A declining dollar would be another tactical tailwind. As such, we are maintaining a modest tactical overweight to emerging-market stocks.

Regards,

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