

## FEATURE: EMERGING MARKET EQUITY INCOME



*“Do you know the only thing that gives me pleasure? It’s to see my dividends coming in.”*

JD ROCKEFELLER

### STATS: INTERNATIONAL DIVIDENDS

FIGURE 1: CONSISTENCY OF PAYOUTS

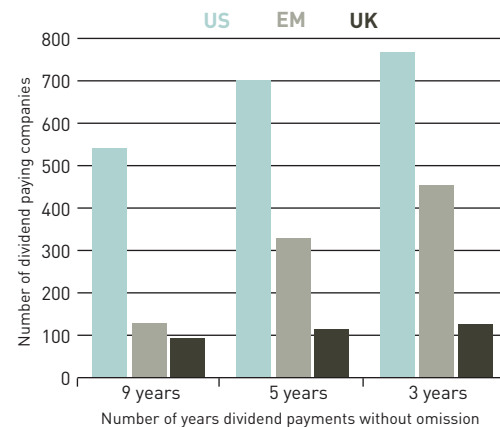
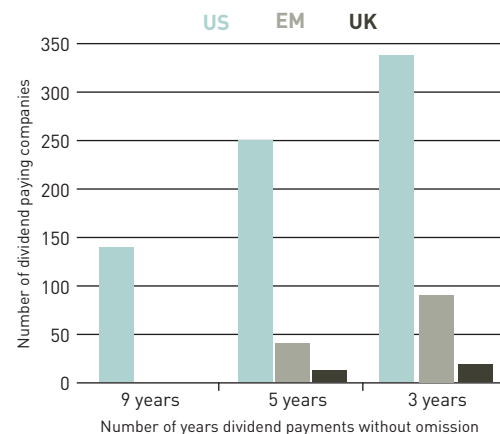


FIGURE 2: CONSISTENCY OF YOY PAYOUT INCREASES



Source: Bloomberg

#### GROWTH IN EMERGING MARKETS

The reality is that a substantial and increasing segment of emerging markets are committed to dividends. Furthermore, what emerging market locals actually want as they grow wealthier is stability and income, not volatility; and why wouldn't they? Growth is only a means to an end. Rockefeller was not a conservative businessman, but his attitude was clear, even in an age of unprecedented US economic growth. The same is true of emerging market entrepreneurs who create wealth and own wealth. In our experience these companies, run by first generation entrepreneurs, have some of the best payout ratios combined with high growth rates. The companies that we worry about are the ones that consistently refuse to pay dividends or do not have a policy as this is often symptomatic of poor financial discipline or a weak understanding of the long-term cost of capital. A good example of the emerging market entrepreneur is Tse Ping, CEO and founder of Sino Biopharmaceutical. The company floated in 2000 and since then has averaged a payout ratio of over 40% combined with an average sales growth of over 20%. Entrepreneurs like this understand that their long-term wealth is not dependent on large sums released from their stock's IPO but the growth in annuity income streams generated by their company.

The drive of the most successful emerging market companies and countries is similar. They want to reform capital markets so that they are less volatile, less dependent on external capital and can build income and capital internally. In some cases they

## STATS

FIGURE 3: TOTAL DIVIDENDS PAID



Source: Bloomberg

have succeeded. The Chilean market is a good example. Reform of the pension system has led to a growth of pension assets to over 50% of GDP from negligible levels, and all listed companies are required to payout at least 30% of earnings. Wealth is consciously being saved and converted into income streams. The Chinese build up of foreign exchange assets invested abroad is also symptomatic of this. The reason the trend is not necessarily obvious is that emerging markets are not yet hugely wealthy and they still have some more traditional 'annuity investments' to make. Many Asian cultures still invest in their children as their primary deferred income asset. As they become richer they will undoubtedly have more money left over for formal equity income plans after funding their children's education.

The statistics support the case for Global Emerging Markets Equity Income overwhelmingly: there are now more mid to large cap companies in emerging markets that have paid a dividend in each of the last nine years than there are in the UK, the stronghold of equity income investing. There are almost four times as many emerging market companies which increased their dividends in dollar terms each year for


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the past five years than there are in the UK. Although there are many more eligible companies in emerging markets which are not paying dividends than in the UK, this highlights the potential of the market rather than a structural weakness. Even though there are still more US companies paying more dividends, more consistently, the gap is closing quickly. In the past 12 months mid to large cap emerging market companies paid out around \$150 billion in dividends – two thirds of the US total and twice that of the UK. Given all this, the biggest surprise is how little attention is given to emerging market equity income as an asset class: there is less than \$10 million devoted to this asset class compared to tens of billions in the UK equity income space.

### A PLACE FOR DIVIDEND INVESTING

It is true that one still needs to be selective, and perhaps this is the main problem for generic ETF access: for every emerging market company promising a high and growing yield there may be another promising not to pay a dividend. For this reason the overall yield is lower (at around 2%) in emerging markets than it is for example in the UK (around 2.7%), however, the yield is growing more quickly. The view that there is no place for dividend investing in emerging markets is old fashioned. Every week we push the agenda for dividends to emerging market companies; every month my team and I meet companies which are freshly considering a dividend policy.

Outsiders, because of their needs, will probably continue to judge emerging markets by the yardsticks of 'excess

growth' and 'more or less beta', but many of the wealthiest insiders are happy just sitting on their steadily increasing dividend streams. After all, continuous dividends are an undeniable pleasure to receive. Finally, a by-product of inverting one's view of emerging markets in this way, in order to focus on the companies with the best dividend streams, is the added benefit of allowing one to be greedy when others are 'risk-adjusted' 

## PROFILE – FACT BOX



### Edward Lam

#### Career highlights:

Edward Lam is the Somerset Emerging Markets Dividend Growth Fund lead manager. A graduate of Downing College, Cambridge University, he began his career at Lloyd George Management covering Asia for emerging markets mandates. He joined Somerset Capital Management LLP in 2007 as head of EMEA and was appointed partner the same year.