WCM | WILDE CAPITAL MANAGEMENT

Portfolio Update

July 27 - 28, 2021

In one of the first material tactical adjustments we found necessary to make in 2021, we have significantly reduced our exposure to Emerging Market equities across our ETF-based portfolios. We did not make a commensurate adjustment in our ESG series portfolios, and the reason will be obvious as we explain below.

We have said numerous times in conversation and in writing, but it warrants repeating here – as goes China so go the emerging markets. As the second or third largest global economy depending on how you quantify the European Union, China has profound influence regionally across Asia Pacific, but also directly and indirectly in developing economies in Africa and Latin America, particularly where natural resources are abundant. It also has an inextricable presence in Western supply chains. China is also steadily tightening its grip on Hong Kong, which is deeply significant economically, and of course heavily influences Taiwan and to a lesser degree Singapore.

This matters because Chinese markets have been showing softness of late, retreating to the same range they found after their initial recovery almost exactly a year ago. More fundamentally though, there are reasons for concern that are not so easily expressed in market returns, at least yet. The further revision of the One Child policy signals a growing recognition that they are facing a demographic problem. Internal immigration into factory cities and urban centers was able to continue almost without limit because of the hundreds of millions of rural citizens potentially available to take newly created jobs. But, the entire population is aging because of the historical birthing policy enforced across the nation, so the available rural wellspring is running dry too. When thinking about long term allocation of capital, this is a generational headwind.

Recent revisions to regulation and policy within China provide additional uncertainty. We have ongoing concerns about governance challenges at the macro level, and a heavier hand from the central authority may tamp down some investor enthusiasm for the promise of truly free markets and private enterprise, particularly if there is a whiff of private companies getting crosswise with the CCP. There is also some sentiment among some of the managers we follow or with whom we work that getting themselves situated for a less close capitalist relationship with the developed West could create some short term discomfort.

China's markets and economy came through, short term disruptions notwithstanding, fairly unscathed given they were the epicenter of the SARS CoV2 outbreak. Their choice to shut down hard and fast controlled the spread, and the politburo tightly controlled the narrative as it pertained to public policy and commerce. We have seen some hotspots of the pandemic erupt there and as they continue to apply the playbook to controlling it markets pick up blips of volatility that sort themselves out quickly. This is to say that over the longer term, while there are some considerable headline challenges they face, the Chinese will find a way, through sheer force of will of nothing else. In the near term though, we think the risks in Emerging Markets driven in large part by China are not being adequately rewarded, while other parts of the world are emerging from the pandemic and can resume their path to growth in a very accommodative environment. For this reason, we reduced our explicit exposure to EM, nearly half dominated by China, Hong Kong, etc. effectively to zero across our ETF-based strategies.

Within our ESG portfolios, which are principally stocked with active management, our exposure to Asia Pacific is driven by fundamentals including a strong bias to good governance and transparency, economic justice, equal access and opportunity, good environmental practices, and other sustainability factors which skew the portfolio away from China except for select opportunities. The result is regional exposure with a significant quality and more developed market bias, meaning that it is not expressly an EM strategy. As such, we did not feel the same impulse to draw down the position because many of our concerns we believe are inherently addressed in the bottom up strategy.

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