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Building on Strength:
Fresh Perspectives on Emerging Markets

Emerging markets (EMs) present a landscape of opportunity for equity investors despite macroeconomic headwinds. In this piece, we asked Paul Birchenough, partner, and Ian Smith, partner, who in 2024 joined Hugo Scott-Gall, partner, as portfolio managers on William Blair's Emerging Markets Leaders strategy, to explain how they seek to take advantage of such opportunities. In a multifaceted discussion, Paul and Ian explain what drew them to William Blair, delve into their philosophy and process, discuss where they see opportunities, and touch on a few areas of the market they're avoiding.

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Portfolio Managers
Paul Birchenough, Partner
Ian Smith, Partner

You both joined William Blair in 2024. What made you a good fit?

Ian: The different portfolio managers on the global equity team at William Blair will naturally have their own leanings and biases. But at the core we're all quality growth investors, and this alignment makes the team a natural fit for us.

Paul: We have a clear view of the traits that we are looking for in the companies in which we invest. This view happens to fit extremely well with William Blair's philosophy around company leadership. In team-based investing, a shared philosophy is essential, as it keeps everyone focused on answering the same key questions.

Ian: It's a good fit in other respects as well—for example, the long heritage that the global equity team has with investing internationally, especially in EMs. And a research process that centers on sector-based analysts, which promotes better informed and more collaborative decision-making. These are things we like, and they make us feel very much at home.

Paul: I would add that the co-management approach on the team also suits us. Ian and I have co-managed portfolios together for nearly a decade. We like the different perspectives, as well as the checks and balances, that this approach brings to investing.

How would you describe your investment philosophy?

Ian: There are different ways for an investor to seek excess returns—value, growth, income, long-only, and long-short, to name just a few—and all are valid. We believe the critical factor in achieving good investment outcomes is having an approach that suits the investment team and having an investment team composed of the right people and equipped with the right tools and processes. You really need good team dynamics. It takes a team of curious and independently minded people to unearth the best investment opportunities, and to stay the course through inevitable market gyrations.

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Paul Birchenough, Partner

You mentioned that the critical factor in achieving good investment outcomes is having an approach that suits the investment team. What is your approach?

Ian: The approach that suits us is owning leading companies, which we call leaders. We've observed that leaders tend to have disproportionate exposure to certain quality-oriented factors, such as sustainable value creation or earnings quality, and we can see empirical evidence for the efficacy of many of these factors over the long term.

Paul: We believe the best equity investments tend to be in companies that can positively surprise the market with respect to the scale or quality of their earnings, or the amount of time that earnings growth can remain elevated. We have found that it is often, albeit not always, the leading companies that are most likely to achieve this. Especially in EMs, where there are many growth opportunities but also many pitfalls, as well as a high and volatile cost of capital. It's not hard to see why these sorts of companies have a habit of positively surprising. We look for companies with a healthy backdrop for growth, sustainable competitive advantages, and capable management that can inspire excellence and make good strategic decisions.

Ian: So, we like to own leading companies. But we also like to buy them when we believe their potential is not sufficiently discounted by the market, and ideally when their leadership is widening as opposed to narrowing.

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Paul Birchenough, Partner

Would you say these companies also have pricing inefficiencies?

Ian: Yes. We believe all securities are susceptible to mispricing for the age-old reasons around information gaps, behavioral habits of investors, and other market inefficiencies. But we believe leading companies have their own additional reasons for being mispriced, because many market participants lean toward shorter investment horizons or narrow valuation measurements, such as price-to-earnings (P/E) ratios, which we believe don’t properly capture the long-term potential of the business. Additionally, as Paul mentioned, these companies also tend to surprise positively more than negatively, perhaps because they enter a new market or redefine industry standards for excellence, and that means they have the potential to produce excess returns that are extremely difficult to forecast.

What was the genesis of your investment philosophy?

Ian: Primarily observation. We try to learn from our own mistakes and successes. We also learn from other investors. Advice from great investors can vary; even Warren Buffett has evolved his approach. But some messages tend to repeat, such as the power of compounding, the difficulty of gaining a truly differentiated insight, the potential competitive advantage of a longer-term investment horizon.

Meet Ian Smith

Before joining William Blair in 2024, Ian was an EM portfolio manager at Newton from 2020 to 2023 and AXA Investment Managers from 2012 to 2020, and a research analyst at Matrix Group and Nevsky Capital. Ian is an Associate Chartered Accountant (ACA), and received a B.A. in economics and politics from Durham University.

What did you want to be when you were growing up?
I was convinced that I was going to be some sort of professional sports star.

How did you get into finance?
Well, it wasn’t a natural course. It certainly wasn’t planned out. Most of my family are medics or teachers. That would have been a more natural path for me. But at school I was always very analytical. I enjoyed math and economics and politics. So, I gravitated toward finance, though I wasn’t sure what role would suit me best.

How did you get into investing?
My first professional job was on a foreign-exchange trading floor. It wasn’t long before I was given an opportunity to work in an investment-oriented role, and I knew immediately that that was what I was meant to do. Compared to other finance roles, it tends to be a little bit more analytical. And it gives you the opportunity to meet lots of different people and think quite deeply about the world around you.

What drew you to William Blair?
It ultimately came down to the realization that I would always regret it if I passed up this unique opportunity. I believe William Blair’s ownership structure lends itself to all sorts of other competitive advantages—attracting and retaining talented people and managing relationships with clients. And that creates a stronger culture.

Did any great investors, in particular, influence you?

Paul: Philip Fisher's *Common Stocks and Uncommon Profits* was a book that particularly resonated with me early in my investment career. It emphasizes the importance of investing in high-quality growth companies with strong management teams, competitive advantages, and long-term potential. Fisher argues that understanding a business deeply and focusing on its qualitative strengths can avoid the pitfalls of market speculation.

Can you elaborate on the characteristics of leaders?

Paul: I think the traits of an exceptional company can be summed up in several key pillars. First, there's the idea of a win-win proposition. This means creating value for everyone involved—selling a product at a fair price and ensuring that everyone in the supply chain benefits. It's the Costco model: when you treat everyone fairly, you get a flywheel effect with repeat customers.

The second pillar is competitive advantage. This is about building strong "moats," whether from brands, human capital, or lowest cost, to secure a lasting position in the market. Then there's the growth runway. Exceptional companies have sustainable growth tailwinds over the long term, whether that's from expanding customer bases in places like India, increased penetration in EMs, or consolidating their industry.

"We also want to own companies that we believe will be the leaders in three to five years, not just today."

Ian Smith, Partner

Finally, quality management is crucial, as mentioned earlier. This means disciplined capital allocation, alignment with us as minority shareholders, integrity, and a winning culture. And it includes clean accounting—a history of transparency.

These traits define a company that is built to lead.

Ian: We also want to own companies that we believe will be the leaders in three to five years, not just today. On the one hand, we're trying to identify the sustainable leaders of today. On the other, we're also trying to unearth the future leaders of tomorrow. This thinking also helps us to avoid the companies that are at risk of losing their leadership status.

> "All industries have the potential to be attractive. We look for those where bargaining power over customers or suppliers can be sustained and growth tailwinds amplify compounding potential."
>
> **Ian Smith, Partner**

Can you provide an example of an attractive industry, based on this framework?

Paul: We've typically had significant exposure to the technology and consumer sectors. Whether it's a bar of soap or a cutting-edge semiconductor, these products deliver strong value at fair prices. In places like Taiwan, Korea, and India, we find companies in these sectors with high, sustainable competitive advantages, from tech leaders to century-old brands that have built customer trust.

We believe technology offers a clear growth runway, especially in segments driving major shifts like artificial intelligence (AI)—what Jensen Huang, the CEO and co-founder of NVIDIA, calls an "Industrial Revolution" in tech. Companies aligned with these megatrends enjoy substantial growth support.

On the consumption side, EMs with rising gross domestic product (GDP) per capita, such as India and Indonesia, enable growth through deeper market penetration, industry consolidation, and premiumization. As incomes rise, consumers in fragmented markets shift to trusted brands, and even within brands, they "trade up" to premium options—from basic washing powder to advanced liquid capsules.

Meet Paul Birchenough

Before joining William Blair in 2024, Paul was an EM portfolio manager at Newton from 2020 to 2023 and AXA Investment Managers from 2011 to 2020; worked as a research analyst at Nevsky Capital; and held various positions in corporate finance, transaction services, and audit at KPMG. Paul is an Associate Chartered Accountant (ACA), and he received a BSc Hons in mathematics from Nottingham University.

What did you want to be when you were growing up?
Initially, I wanted to be a fighter pilot and then a surgeon. After fainting from a vaccination injection, I realized that perhaps that wasn't going to work out.

How did you get into finance?
After studying mathematics at university I interned at Vodafone whilst waiting to start at a Big Four accounting firm, KPMG, in the technology, media, and telecom division.

How did you get into investing?
It really fascinated me because I saw it as an intellectual challenge. You're always learning. So, I got a job as an analyst at a long-short EM equity house. It was luck that I ended up focusing on EMs, but I'm so grateful. I feel quite privileged, getting to travel around the world, understand different cultures, and ask some of the world's most successful businesses questions about how they work.

What drew you to William Blair?
The key differentiator is William Blair's ownership structure and everything it enables—attracting top talent, fostering a strong culture, aligning with clients. Additionally, I believe the firm's heritage in small-cap and EM is a clear advantage. Finally, with a team of 30 analysts and associates dedicating their time to EMs and quality growth, we're exceptionally well-resourced to focus on these high-potential businesses.

Ian: That said, all industries have the potential to be attractive. We look for those where bargaining power over customers or suppliers can be sustained and growth tailwinds amplify compounding potential. Our framework seeks to identify sources of this power—whether through niche market dominance, strong brands, unique intellectual property, or scale advantages.

We're interested in any industry with these qualities and a durable growth opportunity. But we really value companies that can strengthen these advantages over time through superior management and corporate culture.

Can you provide an example of an unattractive industry, based on this framework?

Ian: We don't rule out any industries because industries can change or improve. Right now, though, there are several areas in which we would struggle to invest. In many EMs, banks operate in saturated, fragmented, and heavily regulated financial systems, limiting their potential for sustainable value creation. Mining often faces flat cost curves, which coupled with weak demand can lead to disappointing returns. Healthcare also poses challenges due to regulatory risks.

Paul: Historically, we've had lower exposure to commodity industries, such as oil and materials, where businesses generally lack pricing power and sustainable competitive advantages. In EMs, these sectors often have ties to government ownership, which can complicate governance and minority ownership alignment. While we don't entirely rule out these industries and can find high-quality leaders within them, we tend to find fewer opportunities there.

Ian: We also generally avoid capital-intensive industries with few barriers to competition, where there is no way to stop competitors going head-to-head. Examples are telcos and airlines, though there are exceptions. That said, we appreciate that capital intensity can also act as a barrier to entry, so we don't rule out such industries in which a company's industry dominance allows high returns on capital to be achieved. For example, we own a leading airline in India that emerged from COVID in a very strong competitive position. And there is a well-known Taiwanese semiconductor company that has been able to deter competition; it might be the poster child for high returns despite capital intensity.

What do you see as the most exciting opportunities over the next several years, either from a country, sector, or theme perspective?

Ian: There are, as ever, many excellent growth companies in EMs trading below their intrinsic value. We like to think our strategy holds a good share of these undervalued companies.

Several trends are well-recognized, including the buildout of AI infrastructure, investment needs in power and grid systems, and India's continued economic development. We're still in the early stages of some of these trends—AI is just beginning to scale, and India still comprises less than 4% of global GDP. Yet, there is a clear risk that much of this future potential is already priced in, and so we stay disciplined, focusing on areas where we believe the risk/reward balance remains favorable.

Within consumer sectors, we currently favor experience-oriented products and services, such as travel, food, leisure, and beauty. These areas remain underpenetrated in mature markets such as China, and we anticipate higher growth rates in less developed countries, such as India, when the socioeconomic bell curve shifts to the right.

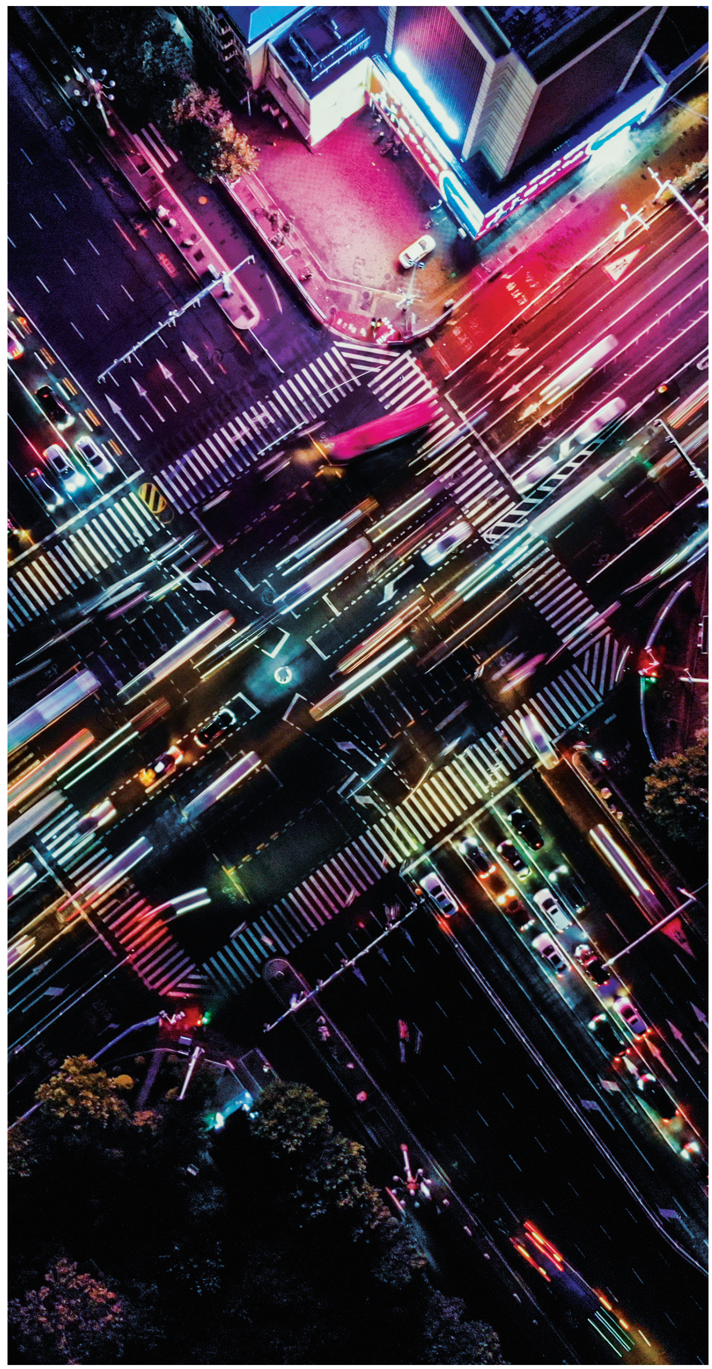
Paul: The global energy transition is a key area of focus for us, driven by five major forces we believe will sustain this theme over the next 5 to 10 years.

The first is the electrical vehicle (EV) shift. Government policies and decreasing costs have driven higher adoption, with EV penetration projected to reach 40% by 2030, according to the International Energy Administration (IEA). Clearly, that's going to put more burden on the grid and require energy storage solutions.

The growth of AI is also intensifying power needs, as data centers and AI applications require substantial energy. For instance, the energy demand of a single ChatGPT query is comparable to 10 times that of a Google search, illustrating the significant power these technologies consume. We're also seeing policy shifts worldwide toward renewables like wind and solar, which are becoming cost-competitive with traditional coal and gas.

"The global energy transition is a key area of focus for us."

Paul Birchenough, Partner



Finally, much of the developed world's energy infrastructure is overdue for replacement, with over 50% of the grid in the European Union and United States exceeding 20 years in age, setting the stage for significant growth after years of underinvestment.

So, while energy transition companies have faced recent challenges due to cyclical pressures, we see potential as penetration remains low for renewables and EVs, and raw material costs—like polysilicon and lithium—have declined, which should help support demand. Our experience over the past five years has shown the value of owning the stronger segments within energy transition supply chains, where competitive advantages are more durable.

Ian, you mentioned China. Any thoughts about the opportunities (or risks) there?

Ian: China's rise has been unprecedented, but over the past 15 years its government has failed to properly address economic imbalances. The economy continues to excessively rely on fixed-asset investments, which has resulted in a bloated real estate industry and high levels of indebtedness within certain sections of society, including amongst local governments and real estate developers.

> "In China we believe the trick for investors will be to get a good sense of the future trends around policy and geopolitics, then identify the types of companies that are likely to benefit, rather than suffer, from the overall direction of travel."
>
> **Ian Smith, Partner**

There are no easy solutions, especially with unsupportive demographic trends and weak consumer sentiment. Despite all of this, China is home to some truly exceptional companies and entrepreneurs, and this should not be underestimated. We believe the trick for investors will be to get a good sense of the future trends around policy and geopolitics, then identify the types of companies that are likely to benefit, rather than suffer, from the overall direction of travel.

Paul: An interesting theme in China is that after years of strong durable goods consumption, especially during COVID lockdowns, we're now seeing a shift toward experiences as a growth driver. E-commerce penetration is among the highest globally, at nearly 40%. But the proportion of citizens holding passports is still low, so there is better scope for long-term growth around spending on experiences such as lodging and travel.

How important is it to understand the impact of macro and geopolitical drivers in EMs?

Paul: We can't ignore the macro environment when investing in EMs. We take a medium- to long-term approach to incorporating macroeconomics into the forecasts and discount rates that drive our investment models. An appreciation for structural versus transient macro drivers can also help us to better understand whether low headline valuations within a country can present an opportunity or not.

Ian: We seek companies with high pricing power and strong balance sheets, and often net cash. When we do see volatility stemming from macroeconomics or geopolitics—which can cause shifts in currencies and inflation—these companies can generally navigate it. For example, they have the pricing power to pass on inflation that passes through from currency weakness, and with strong internal cash flows, they can fund growth without relying on debt or equity markets.

How do U.S. and other developed market monetary policies affect EM equities?

Ian: The U.S. dollar's role as the global reserve currency makes U.S. monetary and fiscal policy crucial for EM returns. U.S. rates effectively set the global risk-free rate and the tone for global liquidity conditions.

Since 1987, there have been two prolonged periods of EM outperformance and two prolonged periods of EM underperformance, with the longest underperformance stretching from October 2010 through today. The common denominator in these periods has been the dollar. A rising dollar is usually bad for EM equities, while a stable or falling dollar benefits them.

Some investments are more sensitive to developed-market macroeconomic and rate cycles than others, but we seek to hold companies with healthier balance sheets (particularly regarding dollar debt) and strong market positioning, which can provide resilience in challenging macro environments.

How do you think about volatility?

Paul: EM portfolio managers are often presented with extreme volatility, sometimes driven by politics or regulation. It can be rewarding to astutely judge risk/reward in these moments—deciding whether to sell or buy more of a stock that has already fallen heavily, judging the difference between a cycle and an ongoing structural decline, and differentiating between a durable trend and a fad. These decisions aren't easy. We follow some rules to help guide our decision-making, but you'll never escape the need for good judgment.

How does valuation play a role in portfolio construction?

Ian: Valuation discipline is crucial—a lesson reinforced in 2022. While we don't need to anchor to low P/E ratios or a value factor, we should avoid buying companies for more than they are worth.

> "Valuation discipline is crucial."
>
> Ian Smith, Partner

Paul: We take a long-term view, putting less emphasis on shorter-term P/E ratios, as we believe they often fail to reflect a company's true intrinsic value and risks.

Ian: We start to get interested in companies when their internal rates of return (IRRs) exceed our threshold.

However, portfolio construction balances multiple objectives. We need to weigh the IRR potential of companies against other considerations around company quality, tail risks, portfolio guidelines, and overall portfolio risk factors.

Fortunately, as portfolio managers we have various resources at our disposal to help with the complex task of balancing these different, sometimes competing objectives.

What are some key lessons you've learned about EM investing over your careers?

Paul: For me, one of the key lessons is getting behind the right people. The quality of management teams, and their incentivization structures, can have a huge bearing on longer-term outcomes for companies in EMs. Management teams can change the trajectory of a business in a positive fashion by avoiding pitfalls and finding new growth opportunities. Yet many EM investors don't put enough emphasis on really understanding the long history of managers and owners of the businesses they invest in.

Ian: EMs have evolved dramatically over my career. Some industries are changing very quickly, and we're presented with ever-more complex situations to assess. I believe market inefficiencies remain fairly abundant in EMs, although they have perhaps become harder to spot. We now have less "sloppy" consensus forecasts, and the market is usually ahead of such forecasts when they do occur. The "easy wins" are largely gone, so it's more important than ever to get things right over the medium and longer term by seeking to predict where we're going to get positive and negative surprises. So, my lessons would include the following: maintain some perspective around the longer-term direction of travel for companies, work with rigor, remain disciplined to your philosophy and process, but also ensure that your process is designed to allow for you to be nimble in an unpredictable and fast-changing world.

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> **Paul Birchenough, Partner**

What do you add to the team?

Ian: We're curious people and like to dive into exploratory discussions around industry trends and addressable market opportunities. And when undertaking company analysis, we tend to disproportionately focus on certain areas, such as assessing management teams and governance structures, and scrutinizing company financial accounts. These are all things typically covered in investment analysis at William Blair, and hopefully there will be instances where we can bring a fresh perspective and help take discussions on such topics to a deeper level.

Paul: After 15 years of investing in EMs, we've had a lot of experience navigating cycles, countries, and politics. We have plenty of "scar tissue," which I believe adds value to the organization. Ian and I have consistently spent time on understanding the people behind businesses, assessing alignment, integrity, and long-term capital allocation decisions. William Blair already places a strong focus on these areas, but we hope to bring an additional layer of insight to the team.

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