Inside the portfolio

Delaware Emerging Markets Fund

Portfolio Manager Liu-Er Chen explains how he looks at the opportunity in emerging markets equity and his approach to finding companies poised for growth trading at discounted prices.

Key fund features

- Investment approach geared towards long-term structural growth opportunities—focus on companies versus countries
- Emphasis on companies with franchise sustainability and attractive valuations
- Dedicated emerging market team has managed the fund since 2006

Liu-Er Chen
Portfolio Manager

Delaware Emerging Markets Fund has been providing investors with strong performance since its inception in 1996. The Fund focuses on stock selection to drive portfolio returns.

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Not FDIC Insured • No Bank Guarantee • May Lose Value
Q: Describe the Fund and its approach to emerging markets.
A: Our approach, first and foremost, is from a bottom-up, stock picker’s perspective. While we pay attention to what’s happening at a macro level, our primary focus is on the individual company. Second, we focus on the long term rather than get caught up in day-to-day volatility. It’s hard to not get disoriented by the ever-changing news cycle, and we feel our long-term investment horizon helps to cut through the noise. Third, at a company level, we focus on a company’s franchise sustainability as it allows us to direct our attention to what matters most in terms of driving long-term value. Fourth and lastly, we are active managers as we seek to outperform the Fund’s benchmark. This is illustrated by our relatively high active share.

Q: Why should investors consider emerging markets?
A: Emerging market economies are growing faster than developed countries, have rapidly growing populations, and better demographics. (i.e. younger, growing work force) Many of these larger economies are experiencing a rising consumer class, which leads to increased growth opportunities. They are undergoing meaningful structural government reforms as well as rampant innovation, especially within the technology sector. Countries such as China are starting to focus on the “quality” of their growth, rather than growth just for its own sake. These fundamental, structural changes are creating a stronger, healthier, and more robust economy for the companies operating within the emerging markets, which should benefit investors over the long term.

Q: Tell us more about “franchise sustainability”
A: Given the continuous 24-hour news cycle, it’s important to have a disciplined process that keeps you from getting disoriented. Our focus on a company’s franchise sustainability offers a framework that helps direct our attention toward what matters most and the key drivers of long-term value. We look to identify sustainable franchises that have strong competitive positions with high barriers to entry, are benefiting from secular growth opportunities, and have resilient and sustainable businesses that are able to weather issues and possibly strengthen during periods of weakness.

Q: Aren’t emerging markets inherently risky?
A: Emerging markets are a volatile space, we won’t deny that. But it’s also where some of the best investment opportunities can be found. This is why we focus our analysis on trying to understand what a company might look like in five years, and whether it will be able to withstand near-term problems that could arise from any number of sources of volatility — geopolitical issues, economic recession, changes in consumer demand, changes in input prices, and so on. We effectively look for companies that we believe are “future proof”, meaning they have either a portfolio of assets or a competitive market positioning that will allow them to better weather potentially tumultuous times. And in some instances, we’ve experienced companies coming out of a volatile period stronger because weaker competitors simply could not survive.

We strive to comprehend the effect of structural changes on how people live and to identify companies across the value chain that are best positioned to generate superior returns.”

Q: How do you manage volatility
A: You can’t manage volatility; it just happens, especially within emerging market countries. What you can manage is how you respond to it. Our focus on the long term combined with our bottom-up, fundamental analysis is key; it allows us to weather the storm and not to overreact as we are able to better assess how a particular event may affect a company’s business over the long term.

To prepare for volatility, we also need to be aware of potential issues that may arise and understand the downside risk that is present. Ultimately, we strive to maintain portfolio diversification because we can never be prepared for all of the potential risks.

Q: Can volatility be a good thing?
A: Absolutely. Volatility can be a good thing for active managers and often works in our favor. Given the inefficiency of the emerging markets space, volatility often presents opportunities to buy great companies that were previously too expensive at a discounted price. Because the market is often focused on the short term, we are able to take advantage of overreactions through our long-term investment horizon. Additionally, volatility often creates an environment where the strongest companies — the ones with attractive franchise sustainability characteristics — are able to take market share from their peers and emerge from volatility stronger.

Q: How do you manage risk?
A: Everyone on the team has a part in risk management. It is a continuous effort through a combination of portfolio construction techniques, as well as fundamental risk assessment of individual holdings. Our fundamental approach is key as it allows us to understand risk, manage it, and ultimately enable us to incorporate it for use in our valuation process. Additionally, we conduct scenario analysis and stress testing on an ongoing basis to monitor risk at the individual company level.

Q: How do you approach valuation?
A: We approach company valuation in several ways as we customize our analysis to fit the type of business we’re researching. We tend to emphasize a company’s long-term earning power. Our analysis focuses on a company’s, or an operating unit’s, ability to consistently earn returns above its cost of capital — to create value over time that accrues to shareholders. We pay particular attention to upside potential and especially toward downside risk. Ultimately, we are looking for companies that are trading at discounts to their intrinsic values.
Emerging markets valuations and growth prospects are compelling

Emerging markets offer growth at attractive valuations relative to developed markets

Q: Would you elaborate on ‘intrinsic value’?
A: By intrinsic value, we simply mean what we believe a company is worth. It’s a subjective assessment that is central to how we think about an investment opportunity and often our analysis differs significantly from how the market is currently pricing a stock. This is partly because we tend to think longer term than typical market participants, as we seek to answer the question: “What will the company look like in five years?” It’s also because we consider various methods of valuing a company, tailoring them to what makes the most sense given a company’s business model or the assets on the balance sheet. We look for stocks that we believe are trading at a minimum of a 25% discount to intrinsic value.

Q: From a style perspective, do you consider yourself “growth” or “value”?
A: There are elements of both investment styles in our approach; we often own companies that have strong growth potential but we have a strict valuation discipline. How our portfolio characteristics profile at any given moment is more a result of what the market ascribes to the stocks we own at that time. But we’re thinking structurally much further out, so snapshot portfolio statistics do not necessarily reflect our longer-term view on growth potential or valuation. Longer term, it’s probably most fair to consider our portfolio a “core” strategy.

Q: And you are US-based? Is that a challenge given your focus on emerging market countries?
A: We don’t think so. Information is free flowing and we have access to most of what we need at our fingertips. We do travel into our regions of coverage several times a year to get a closer feel for the businesses in their local markets, but this is not as important a factor as it may have been 20 years ago. We also benefit from good company access to corporate management teams.

Q: You have a strong long-term track record; what do you think is the key factor?
A: We believe that consistently applying our investment process is the key driver of long-term performance. We emphasize bottom-up stock selection with a long-term investment horizon rather than top-down asset allocation. We closely observe key developments taking place within the market, and we strive to understand how those affect the long-term competitiveness, growth prospects, and earnings power of individual companies. Based on our analysis, we seek to invest in companies with sustainable franchises, strong growth prospects, and valuations significantly below their intrinsic values.
For more information call us at 877 693-3546 or visit our website at delawarefunds.com

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Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged and one cannot invest directly in an index.

The MSCI Emerging Markets Index represents large- and mid-cap stocks across emerging market countries worldwide. The index covers approximately 85% of the free float-adjusted market capitalization in each country. The MSCI EAFE (Europe, Australasia, Far East) Index represents large- and mid-cap stocks across 21 developed markets, excluding the United States and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country. Index “gross” return approximates the maximum possible dividend reinvestment. Index “net” return approximates the minimum possible dividend reinvestment, after deduction of withholding tax at the highest possible rate. The S&P 500 Index measures the performance of 500 mostly large-cap stocks weighted by market value, and is often used to represent performance of the US stock market.

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