

# Harding Loevner Frontier Emerg Mkts Inst HLFMX

A strong team, but risk-management questions remain.

## Morningstar's Take HLFMX

**Morningstar Rating** ★★

**Morningstar Analyst Rating** Bronze

### Morningstar Pillars

Process	● Above Average
Performance	—
People	● Above Average
Parent	● Above Average
Price	—

### Role In Portfolio

Specialty

### Fund Performance

Year	Total Return (%)	+/- Category
YTD	-0.25	-4.31
2020	0.11	-17.80
2019	10.89	-8.36
2018	-15.44	0.63
2017	25.09	-9.08

Data through 2-28-21

8-19-20 | by Nicholas Goralka

Harding Loevner Frontier Emerging Markets' competitive team and sensible process contribute to a Morningstar Analyst Rating of Bronze on the cheaper share classes, while the more expensive receives a Neutral rating.

This strategy's strong leadership and robust supporting cast stand out. Co-lead manager Pradipta Chakraborty has been on the team since the end of 2008, while the other co-lead manager, Babatunde Ojo, joined the team as an analyst in 2012. Ojo became manager in 2016 after spending two years running a paper portfolio. Before joining Harding Loevner in 2012, he served as the head of equity research and a portfolio manager at Asset & Resource Management Company and worked at PricewaterhouseCoopers and Intercontinental Bank in Nigeria. Ojo and Chakraborty each manage half of the strategy's assets independently and have 30 other investment professionals from which to draw support.

While this strategy's risk-conscious approach has merit, it hasn't effectively mitigated damage in tumultuous markets. The managers focus on firms that have healthy balance sheets, clear competitive advantages, and other positive attributes as well as strong growth rates. They pay close attention to the strategy's risk exposures, scaling positions in companies based on the managers' perceived risk in the countries where they are domiciled. However, that approach hasn't stopped the strategy from performing terribly in recent drawdowns, including the first quarter of 2020. The managers often build sizable sector and country bets, resulting in a distinctive portfolio of roughly 70 to 90 names.

Discipline has earned good results over time here, but recent returns have been disastrous--the strategy lost a cumulative 18.3% in the five years preceding August 2020 (worse than the relevant indexes), while 10-year returns were flat. While the expense ratios of the two older share classes are much lower than they used to be and offer investors a reasonable frontier-markets vehicle for the right price, investors should still be cautious before dipping their toes into such choppy waters.

**Process Pillar** ● Above Average | Nicholas Goralka 08/11/2020

While this strategy's risk-conscious approach hasn't effectively mitigated damage in tumultuous markets, it has worked well at several other Harding Loevner strategies, meriting an Above Average Process rating.

The two managers focus on firms that have healthy balance sheets, clear competitive advantages, and other positive attributes as well as strong growth rates. They pay close attention to the strategy's risk exposures, scaling positions in companies based on the managers' perceived risk in the countries where they are domiciled. When a

country has marked risk (usually as represented by its sovereign credit rating), they build smaller positions in stocks they find compelling than they otherwise would, and when conditions deteriorate, they sometimes sell positions entirely. For example, they sold Saudi fast food provider Herfy Food Services when the government implemented new fiscal austerity measures after oil prices collapsed in early 2020. However, that approach hasn't stopped the strategy from performing terribly in recent drawdowns, including the first quarter of 2020.

The managers search far and wide for stocks that meet their standards, and they often build sizable sector and country bets, resulting in a distinctive portfolio of roughly 70 to 90 names with solid profitability metrics and moderate price multiples.

Frontier-markets strategies rarely resemble their benchmarks, and this strategy is no exception. It has always run about a 10-percentage-point financials underweight under its two co-lead managers compared with the MSCI Frontier Emerging Markets benchmark, while carrying a similarly sized consumer staples overweight. It also allocated much more to tech than its benchmark or the MSCI Frontier Markets Index, another fair comparison given this strategy's lower investment in the Philippines and other small emerging markets.

The portfolio's aggregate profitability metrics look better than both indexes as measured by return on assets and equity, a side effect of the managers' high standards for growth rates. Furthermore, the portfolio's price metrics tend to be roughly in line with those of both indexes and considerably cheaper than broader emerging-markets benchmarks and the diversified emerging-markets Morningstar Category.

However, frontier-markets indexes don't necessarily represent well-rounded portfolios. The MSCI Frontier Markets Index, for example, only holds 88 stocks, and 25% of its assets are held in two Kuwaiti financials: National Bank of Kuwait and Kuwait Finance House. Any comparisons to the characteristics of those benchmarks should be made with caution.

### Performance Pillar | Nicholas

Goralka 08/11/2020

This fund normally invests much less in the Philippines and other small emerging markets than its benchmark, the MSCI Frontier Emerging Markets Index (which invests sizable amounts in such markets). It therefore makes sense to compare this strategy's performance to that of the MSCI Frontier Markets Index (which invests exclusively in frontier markets) as well as to that of its benchmark. Through that lens, this strategy has posted strong results since its longest-tenured manager Pradipta Chakraborty became manager at the end of 2008. It has comfortably outpaced both indexes since that time while carrying less volatility, leading to strong risk-adjusted metrics as well. However, most of that performance came in his first year, as the strategy outperformed both indexes dramatically in 2009.

In more recent years, however, the strategy has struggled mightily--its three-, five-, and 10-year returns all lagged both relevant indexes through July 2020. Making matters worse, this underperformance came amid a dreadful five years for frontier-markets equities at large, resulting in a 18.3% loss over the five years prior to July 2020 (worse than the relevant indexes), while 10-year returns were 0.0%. Investors should be aware that frontier markets can be very volatile, as evidenced by their dramatic underperformance compared with broader emerging markets in the first half of 2020.

### People Pillar Above Average | Nicholas

Goralka 08/11/2020

The two co-lead managers' experience and their robust supporting cast contribute to an Above Average People rating.

Co-lead manager Pradipta Chakraborty has been on the team since the end of 2008. He has been a comanager on Silver-rated Harding Loevner Emerging Markets HLEMX since early 2015. Co-lead manager Babatunde Ojo joined the team as an analyst in 2012, becoming named manager in 2016 after spending two years running a paper portfolio. Before joining Harding Loevner in 2012, he served as the head of equity research and a portfolio manager at Asset & Resource Management Company and worked at PricewaterhouseCoopers and Intercontinental Bank in Nigeria. Ojo and Chakraborty each manage half of the strategy's assets independently, though their individual portfolios rarely deviate significantly.

Former managers Rusty Johnson and Richard Schmidt gave up their comanager positions here in early 2017 and early 2018, respectively, but Schmidt remains at Harding Loevner and serves as a resource for Chakraborty and Ojo. Schmidt continues to serve as a consumer staples analyst as well, also serving as a comanager on Harding Loevner Emerging Markets, and comanager on Harding Loevner Global Equity HLMVX.

Chakraborty and Ojo have 30 other investment professionals from which to draw support.

### Parent Pillar Above Average | William Samuel

Rocco 07/24/2019

Harding Loevner, which is majority-owned by AMG, is a well-established and -staffed firm that specializes in international-equity funds. Daniel Harding and David Loevner ran global accounts before they founded the company in 1989, and co-CIO Simon Hallett and co-CIO and portfolio manager Ferrill Roll had ample foreign investing experience when they joined the firm in the early 1990s.

The firm launched five international-stock funds for U.S. investors between 1994 and 2008 before opening three more during the past few years. (It also has several international-equity separately managed accounts for U.S. investors and UCITs for overseas investors.) All use the same quality-growth strategy. That approach is sound and risk-conscious, and it has earned strong risk-adjusted

results overall. Harding Loevner, which has roughly \$70 billion in assets, has done an excellent job of hiring and retaining investment professionals as it has grown and aged. Indeed, there are 38 individuals on its investment team, and the team has an attractive mix of very seasoned veterans who have been with the firm for decades, experienced investors who have been with the company for many years, and more-recent arrivals who have between a few months and a couple of decades of experience.

Harding Loevner has so-so fees. But manager ownership is solid, and it treats its fundholders well, so it merits a Positive Parent rating.

### Price Pillar | Nicholas Goralka 08/11/2020

It's critical to evaluate expenses, as they come directly out of returns. The share class on this report levies a fee that ranks in its Morningstar category's costliest quintile. Such high fees stack the odds heavily against investors. However, based on our assessment of the fund's People, Process and Parent pillars in the context of these fees, we still think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Analyst Rating of Bronze.

### Average annual returns (%)<sup>1</sup> (as of 03/31/21)

	Inception	Q1	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Incpt
HLMOX (Investor)	12/31/10	-2.16	-2.16	43.72	-4.88	2.83	1.17	0.72
HLFMX (Institutional I)	05/27/08	-2.03	-2.03	44.23	-4.56	3.22	1.57	-0.87
HLFFX (Institutional II)	03/01/17	-2.02	-2.02	44.67	-4.30	-	-	2.88
Benchmark	-	-6.08	-6.08	33.58	-4.29	2.46	1.45	-

**Expense Ratios (gross/net):** Investor Class 2.12% / 2.00%, Institutional I Class 1.68% / 1.68%, Institutional II Class 1.60% / 1.35%

### Top ten holdings (%)<sup>2</sup>

Holding	% of Net Assets
Hoa Phat Group	4.81
EPAM Systems	4.66
Globant	4.51
Safaricom	4.09
Commercial International Bank	4.06
SM Prime Holdings	4.01
Vietnam Dairy Products	3.81
Banca Transilvania	3.68
Ecopetrol	3.11
Halyk Savings Bank GDR Reg S	3.08
TOTAL %	39.82

<sup>1</sup> Returns for periods less than one year are not annualized.

<sup>2</sup> Mention of a specific security should not be considered a recommendation to buy or a solicitation to sell that security. Holdings are subject to change.

The performance data shown represents past performance. Past performance is not a guarantee of future results. Current performance may be lower or higher than the performance data quoted. The investment return and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. For performance information through the most recent month end please call 800.835.3879 or visit our website at amgfunds.com.

## Disclosure

***Investors should carefully consider the fund's investment objectives, risks, charges, and expenses before investing. For this and other information, please call 800.835.3879 or download a free prospectus. Read it carefully before investing or sending money.***

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The MSCI Frontier Emerging Markets (FEM) Index captures large and mid cap representation across certain Frontier Emerging Markets countries. Please go to [msci.com](http://msci.com) for most current list of countries represented by the index.

Unlike the Fund, indices are unmanaged, are not available for investment and do not incur expenses.

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The Manager Research Group evaluates funds based on five key pillars, which are process, performance, people, parent, and price. The Manager Research Group uses this five-pillar evaluation to determine how they believe funds are likely to perform relative to a benchmark over the long term on a risk adjusted basis. They consider quantitative and qualitative factors in their research. For actively managed strategies, people and process each receive a 45% weighting in their analysis, while parent receives a 10% weighting. For passive strategies, process receives an 80% weighting, while people and parent each receive a 10% weighting. For both active and passive strategies, performance has no explicit weight as it is incorporated into the analysis of people and process; price at the share-class level (where applicable) is directly subtracted from an expected gross alpha estimate derived from the analysis of the other pillars. The impact of the weighted pillar scores for people, process and parent on the final Analyst Rating is further modified by a measure of the dispersion of historical alphas among relevant peers. For certain peer groups where standard benchmarking is not applicable, primarily peer groups of funds using alternative investment strategies, the modification by alpha dispersion is not used.

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