Beat The Market By Investing In Freedom – And Shunning Places Like Russia And China

When Russia's invasion of Ukraine sent most emerging-markets funds plummeting, Perth Tolle's Freedom Index Fund avoided most of the carnage—because economies run by despots will never be on her buy list.

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Most important lessons aren't learned in the classroom. In 2003, the year after Houston money manager Perth Tolle graduated from Trinity University in San Antonio with a degree in finance, she spent a year in Hong Kong living with her father, reconnecting with her Chinese roots. On a visit to Shanghai, Tolle befriended a woman named Maggie. Both were 23 years old, but her new friend's dark backstory shocked Tolle. While Tolle had enjoyed a suburban upbringing in Plano, Texas, Maggie lived in the shadows. She had no birth certificate, no school or hospital records and no safety net. To the Chinese government, Maggie didn't exist. She was one of tens of millions of kids victimized by the Communist Party's one-child law, in effect from 1980 through 2015. Because her parents already had a son, they concealed her upbringing.

"That policy changed the culture of my generation, and the effects of the demographic disaster in China are irreversible," says Tolle, 42, who was born in Beijing but came to the U.S. at age 9. "I had this realization that freedom made a difference in my life and in the markets."

China is a core holding of most emerging-markets funds, making up 30% of the MSCI Emerging Markets Index, but if you were to peer into the portfolio of Tolle's Freedom 100 Emerging Markets ETF, you wouldn't find a single Chinese stock. The fund she manages with Havertown, Pennsylvania–based ETF issuer Alpha Architect is still relatively small, but it has grown from $30 million at the beginning of 2021 to $200 million today. It has no investments in Vladimir Putin's Russia either. As a result, year to date MSCI's emerging-markets index is down 17%, but Tolle's Freedom fund is off only 7.5%. Think of the Freedom ETF as a close relative of popular ESG funds, but instead of worrying about the environment or corporate governance, Tolle avoids investing in regimes that infringe on personal and economic freedoms.

Those risks crystallized last year, when China imposed a series of arbitrary fines against its largest tech companies, including a $2.8 billion penalty on Alibaba. Tencent and Alibaba were forced to pledge more than $30 billion to the government's "common prosperity" initiatives—a gesture of appeasement Tolle calls "shareholder theft"—and their stocks cratered. China also forced its thriving online tutoring companies to become nonprofits. Multibillion-dollar fortunes were erased overnight: Larry Chen, the founder of Gaotu Techedu, lost $10 billion last spring.

China's woes dragged the MSCI Emerging Markets Index to a 2.5% loss in 2021, while Tolle's fund gained 6.9%.

What does the Freedom ETF hold? Currently 21% of its portfolio is in Chilean companies such as Sociedad Química y Minera de Chile, one of the world's largest producers of lithium (in demand for electric vehicle batteries) and iodine, which is essential for X-rays. Taiwan also ranks highly, as do South Korea and Poland.

"Freer markets have more sustainable growth. They recover faster from drawdowns and they use their capital and labor more efficiently," Tolle says. "I always expected that they would outperform, but I didn't expect it to play out this quickly."

Tolle originally intended to go to law school, but after her year in Hong Kong she began working as a financial advisor for Fidelity, first in Los Angeles and then in Houston. She had clients from Russia, Iran and Saudi Arabia who told her they wanted to avoid investing in their home countries, likening it to funding terrorism. That sensibility mirrored how she felt about China.

In 2014 she quit Fidelity to raise her daughter but continued attending industry conferences as she mulled the idea of a freedom fund. In 2016 she was invited to Cumberland Advisors' exclusive Camp Kotok gathering of investment managers, traders and economists in Maine's northern woods. On her way there she shared a seaplane with Rob Arnott, founder and chairman of Newport Beach, California–based Research Affiliates and an advocate of non-cap-weighted indexing strategies.

"He heard my idea while I had him as a captive audience in the plane, because he couldn't do anything about it. He loved it," Tolle recalls.

After three days of fishing and drinking wine at the camp, Arnott committed to backing Tolle and later became an investor in her firm, Life & Liberty Indexes. Tolle created her index and shopped it to BlackRock and State Street, which turned her down. In 2018, she struck a deal with Alpha Architect, launching her ETF with the ticker FRDM in May 2019. Freedom 100 Emerging Markets ETF has a 0.49% expense fee, most of which goes to Tolle.

Working from her Houston home, Tolle rebalances her index yearly using the Human Freedom Index score calculated for 165 countries by the Cato Institute and Fraser Institute. The index rates economic and personal freedom on a scale of 0 to 10, using 82 variables covering everything from jailed journalists to international trade policy.

The freest emerging nations with liquid markets in 2021 were Taiwan (No. 19), Chile (28) and South Korea at 31 (the U.S. ranked 15th). Tolle takes the top 10 or 11 emerging markets and weights them based on their freedom scores; she then examines the 10 largest non-state-owned stocks in each country and weights them by market cap within their country weights.

Russia and China ranked 126th and 150th, respectively; from 2019 to 2021, India dropped from 94th to 119th after it blacked out the web to suppress farmers' protests. Tolle's ETF cares little about traditional ESG matters like carbon footprint, owning stock in Brazil's iron giant Vale and Chilean forestry and energy conglomerate Empresas Copec.

Although the fund is down in 2022, its assets are double where it ended 2021 thanks to record inflows following Russia's invasion of Ukraine.

"What Russia did opened investors' eyes to the risk in China," Tolle says. "Market-cap weighting just doesn't work as well with emerging markets because it creates a dictatorship-funding monster. That's what we're here to solve."