EMERGING MARKETS | MARKETS AND ECONOMY | OUTLOOK

2023 Investment Outlook: Emerging Markets

By: EV Forward | December 14, 2022

Opportunities in Emerging Markets, Navigating Beyond China

KEY POINTS

1 Emerging markets (EM) have better growth, lower inflation, and less sovereign and private debt, yet EM equities and currencies trade at crisis-level valuations.

2 Despite the slowdown in China, we expect many other EM countries to see an acceleration in growth, which will drive earnings and market share.

3 The growth story is underpinned by the post pandemic recovery, a manufacturing renaissance, commodity tailwinds, digitization and a favorable political cycle.

4 We believe that most investors are under-allocated to EM, considering the potential returns from this asset class.

During the 2010s EM equities suffered their worst performance as an asset class going as far back as the 1930s. Fast forward 10 years and most emerging countries, with the exception of China, started the 2020s in much better shape economically than in the previous decade. Emerging Countries such as Brazil, Mexico, India, Indonesia and the GCC (Gulf Cooperation Council) outperformed not only the MSCI Emerging Markets Index but even the S&P 500 Index in 2022.

Several factors have contributed to this outperformance. The headwinds of the past are becoming tailwinds that we believe should provide support for many years to come.

- Relative growth differentials favor EM equities.
- EM sovereigns are healthier compared to developed markets (DM) governments due to better public debt and fiscal situations.
- EM corporates are in better shape compared to DM corporates due to deleveraging.
- EM external balances have improved relative to DM.
- EM equities and currencies are trading at decade-low valuations.

Navigating beyond China

Growth in China will be weighed down due to its high debt, slowing working-age population growth and declining contribution from trade. In the 2000s, China became the manufacturer to the world, and in the 2010s, China's economy grew thanks to consumer Internet service giants.

We believe the next turn in this decade will be toward green technology and science-based industries like semiconductors, artificial intelligence and high-end manufacturing. Despite the slowdown in China, we expect many other EM countries to see an acceleration in growth, which will drive relative earnings and market share.

The growth story of EM is underpinned by several factors:

- Post-COVID recovery led by credit creation after a period of deleveraging
- Manufacturing revivals in certain markets led by the "China plus one" strategy that drives reshoring and friend shoring
- Commodity boom driven by resource-intensive decarbonization, which benefits resource-rich economies
- Boosts to productivity and growth led by digitalization across most EM regions
- Favorable political cycles in several pockets of EM

It is important to note that since the MSCI index inception in 1988, emerging economies have weathered many storms — and yet they have outperformed developed markets, perhaps surprising many commentators. Since 1988, the MSCI EM Index has gained 9.7% annualized, outperforming many of the MSCI tracked asset classes, albeit with higher volatility.

This is why we believe EM offers greater opportunity for active management to add value over the course of EM economic and market cycles. While drawdowns in EM are common, these often provide the best entry points for gaining exposure to the long-term positive trend return. Despite better growth, less debt and lower inflation, EM equities are trading at crisis-level valuations today.

We believe that most investors are under-allocated to EM, considering the potential returns from this asset class. For many investors, EM remains unloved and clearly under-owned. The environment for investing in EM will never be easy, but by focusing on active country selection, stock selection and structural themes, we believe investors can reap the rewards of investing in these markets particularly at this stage of their economic and market cycle.

Jitania Kandhari
Deputy CIO of the Solutions and Multi-Asset Group
Co-Lead Portfolio Manager for Active International Allocation
Head of Macro and Thematic Research for Emerging Markets Equity

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

MSCI Emerging Markets Index is an unmanaged index of emerging markets common stocks.

Risk Considerations: *The value of equities securities fluctuate in response to activities specific to a company. Investments in foreign markets entail special risks such as currency, political, economic, market and liquidity risks. The risks of investing in emerging market countries are greater than risks associated with investments in foreign developed markets. ESG Strategies that incorporate impact investing and/or Environmental, Social and Governance (ESG) factors could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. As a result, there is no assurance ESG strategies could result in more favorable investment performance. When comparing asset classes, keep in mind that each has differences and that all investments involve risks, including the possible loss of principal. Investments in foreign markets entail special risks such as currency, political, economic, and market risks. The risks of investing in emerging market countries are greater than risks associated with investments in foreign developed markets.*

EV Forward

"Most emerging countries, with the exception of China, started the 2020s in much better shape economically than in the previous decade."