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2023 Investment Outlook: Emerging Markets Equity

By: EV Forward | December 15, 2022

After a Tough Decade, Emerging Markets Are Ready to Shine

KEY POINTS

- 1 It's time for emerging markets to shine in the next decade.
- 2 Growth expectations have been reset and appear to be priced in.
- 3 Opportunities await, even with risks ahead

What We Are Seeing

2022 capped a difficult decade-plus period of underperformance for emerging markets (EM).

Many wonder, for example, whether some markets like China is investable at all, after a series of regulatory overhangs, political developments and strict COVID policies.

Last year saw a reset of growth expectations, irrespective of the earnings growth potential and managements' execution ability, while U.S. dollar strength seems to have peaked.

EM economies should benefit from not having to counteract the short-term "sugar high" of COVID stimulus, as is the case in many developed market countries.

Despite global worries over the war in Ukraine, China-U.S. tensions and an impending recession in the U.S., EM seems to be well-positioned for a constructive 2023 — and beyond.

What We Are Doing

While EM Leaders is primarily focused on bottom-up, structural opportunities, we are also adapting to higher global interest rates which are unlikely to drop significantly in the years ahead.

EM Leaders was slow to respond to the sharp jump in rates and the massive derating of companies that are not yet profitable. We have addressed this by shifting the portfolio in recent quarters.

Since the derating of strong compounders (defined as companies with high quality, franchise businesses, recurring revenues and pricing power, among other things), we have deployed capital into industry leaders with clear earnings visibility, while finding new investment themes such as the rise of domestic manufacturing and brands.

While the market focuses on the near-term path of inflation rates, we are spending more time on the road with the company management teams of existing holdings, always on the lookout for new ideas.

What We Are Watching

We have an eye on China, which has been negatively impacted by COVID-19 lockdowns. Political developments could heighten policy risk, but given economic pressures and government support measures, we expect economic activities will eventually normalize — and provide surprises on the upside.

The market has yet to differentiate between winners and losers, but we believe that will be evident in the next cycle. For example, Indian IT services with a much lower growth outlook are trading at the same multiples as niche, digital IT services companies with twice the likely growth rate.

The seasoned management teams of our portfolio companies are reassessing and recalibrating their growth strategies to drive profitability

and increase their market share.

Geopolitical tensions between the U.S. and China will likely provide entry points for other EM supply-chain capabilities, like iPhone production shifting to India.

For the first time in a decade, we are seeing high-quality EM growth companies offering 15 to 20 times PEs, coupled with 20% return on invested capital (ROIC) and 20% earnings growth — a great investment backdrop for the next three to five years.

We feel that some of the larger continental-sized markets within EM are well-positioned for the coming decade.

Vishal Gupta

Portfolio Manager

Emerging Markets Leaders

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EV Forward

"We expect emerging markets to benefit from the shift in growth for the decade ahead, with entry prices looking attractive."



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