May 2024

—
Investing for a
world of change

Q&A with Varun Laijawalla: eyeing the EM opportunity

From tech innovation and changes in the global supply chains to shifting regulatory environments and upcoming elections, allocators have a great deal to consider when investing in emerging markets.

We sat down with Ninety One's co-Portfolio Manager of the Emerging Markets Equity Strategy, Varun Laijawalla, to address some of the recent questions from allocators on how and where to find alpha in emerging markets.

Varun Laijawalla
Portfolio Manager

—

For professional investors and financial advisors only. Not for distribution to the public or within a country where distribution would be contrary to applicable law or regulations.

Given the strong run in Indian equities, do valuations still stack up?

India has been a bright spot in emerging markets over the past few years. The economy has been growing strongly, and the government has been very clear and transparent in its objectives. This has helped position India as a reliable partner and ultimately an attractive destination for foreign capital. This is in stark contrast to neighbouring China, which remains opaque. Being underweight China and overweight India is probably the most crowded trade among EM managers over the past 6-12 months. This is not unique insight. India's remarkable rise over the past 5-6 years has seen its weighting in the EM index[1] grow from approximately 10% to 20%[2]. The question from here is, how do you generate positive returns from a country which has seen such a rapid ascent and currently trades at all-time highs? The easy money from simply being overweight India Inc. has been made – the future path for incremental passive gains is less clear.

The solution lies in an active approach through bottom-up stock picking. We don't own India to simply own India, we own stocks because we like them and want to invest in them, and it just so happens more of them are coming from India. There are several structural tailwinds which excite us still, including the Aadhaar biometric identification system, which will help drive financial and social inclusion; a more tightly regulated property sector; streamlining India's goods and services tax (GST); defence and capital infrastructure spending and the privatisation of the banking sector. Read our recent note here.

1. For further information on indices, please see the Important information section.
2. MSCI, December 2023.

The UAE is experiencing tremendous growth – how do you see that playing out?

The UAE is one of the most compelling opportunities within emerging markets today. It is a confederation of seven emirates, of which Abu Dhabi and Dubai are the most significant. Abu Dhabi accounts for c.87%[3] of the land area of the UAE and unsurprisingly accounts for nearly all of the oil production. This has forced the other remaining emirates to create alternative non-oil backed identities with which to engage the outside world. Dubai, for example, has focused its efforts on developing itself as a regional entrepot and financial centre, while also positioning itself as the region's leading tourist destination. While the UAE has always been a relatively open country in terms of trade and immigration, it has upped the ante in recent years to become a much more accommodative and competitive partner.

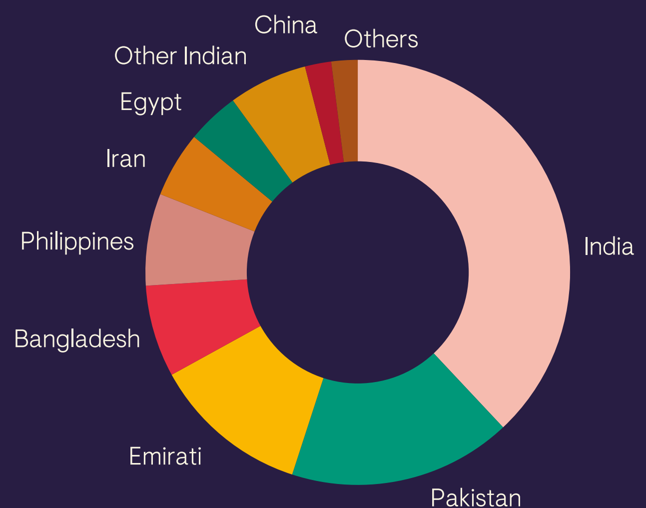
The most compelling part of the investment case is its openness to trade, and how this has shaped the population breakdown, and the opportunities that presents. It has re-emphasised its openness to trade through the vehicles of Comprehensive Economic Partnership Agreements (CEPAs) which it is signing with key trading partners. CEPAs are intended to enhance market access, lower or eliminate tariffs, simplify customs procedures and make sure trade is conducted clearly and transparently. The most significant CEPA in the long-run is likely to be that with India.

Comprehensive Economic Partnership Agreements (CEPA)

	Date of signing
India	18 February 2022
Israel	31 May 2022
Indonesia	1 July 2022
Turkey	3 March 2023
Cambodia	8 June 2023

Source: UAE Ministry of Economy, December. 30 April 2024.

Figure 1: UAE population breakdown (2023)



Source: Infographics, 31 December 2023.

3. Abu Dhabi Residents Office.

The CEPA eliminates or reduces tariffs on more than 80% of goods exports to India from the UAE, and also significantly eases barriers around trade in services. It potentially positions the UAE as India's offshore trade and financial hub, much as Hong Kong has performed that service for China for many decades.

The openness to do business has facilitated the mobility of people through accommodative immigration policies. Emiratis (natives of the UAE) make up just c.12% of the c.10 million population. Until recently, the status of most of these immigrants within the UAE was relatively precarious, as residency was tied to a work visa, and if employment at that particular employer ceased, the visa automatically ceased as well. But the game-changer here has been the introduction of 'Golden Visas' in 2019. These allow 'exceptional talents' the right to live and work in the UAE through a 10-year renewable visa. The game-changing aspect here is that these visas or not tied to an employer or a specific employment.

The influx of immigrants is obviously driving demand for property, with property prices setting new highs (the previous highs were a decade ago in 2014). The market appears a touch cynical about the strength in the property market, with both the largest UAE property companies trading at only single-digit multiples a year out. This is where we see the greatest investment opportunity.

However, the real change in the Gulf of Arabia in the past decade has been the clear realisation that the future will be different from the past, and that this requires transformational change (not just in the UAE, but in Saudi Arabia and elsewhere). The current reliance on oil is now seen as unsustainable (in all senses of the word) and the UAE is at the forefront of the multi-decade change that needs to happen. The UAE is not waiting for the future to happen to it, it is seizing the moment and pro-actively building its own future – this is a country with a clear vision, a strong focus and a dynamic plan to execute around it.

Is there any meat to South Korea's Value-up programme?

South Korea is currently in the midst of launching its Corporate 'Value-up' programme, which aims to prioritise shareholder returns and ultimately increase the value and prominence of South Korea's equity market. Japan undertook a similar initiative and equity markets are starting to reap the benefits. A recent research trip to Seoul (our note on it can be viewed here) made it clear that most companies are in 'wait-and-see' mode. The government wants companies to do more to attract foreign capital, but the companies want to be incentivised to do so, with the most favoured approach being accommodative tax cuts.

To date, there have not been any concrete policy announcements, but there have been a few crumbs in recent weeks. The first update came towards the end of February, but lacked teeth and fell short of market expectations. The government only went as far as to 'encourage and support companies' voluntary efforts to return more capital to shareholders and improve governance' when in reality much firmer regulation, with the potential to name and shame those companies who dragged their feet, would have been more impactful.

Interestingly, in a positive development on 20 March, we heard the Finance Minister explicitly state – for the first time in public – that it was the intention of the sitting government to cut taxes to drive the Value-up programme forward. This was a timely reminder to the market that the government was in fact listening, but more detail is needed.

We are currently underweight South Korea but hold meaningful allocations to the country across our Emerging Markets and Asia Equity portfolios. This reflects our recognition that while operating a business in South Korea's current corporate climate is not straightforward there are companies that can successfully navigate those hurdles and their respective business strategies provide the necessary growth levers.

Our 4Factor process ensures we stay focused on what we believe are the key share price drivers for the companies we monitor, and any advancement in the Value-up programme will likely present us with more opportunities to add to our bench.

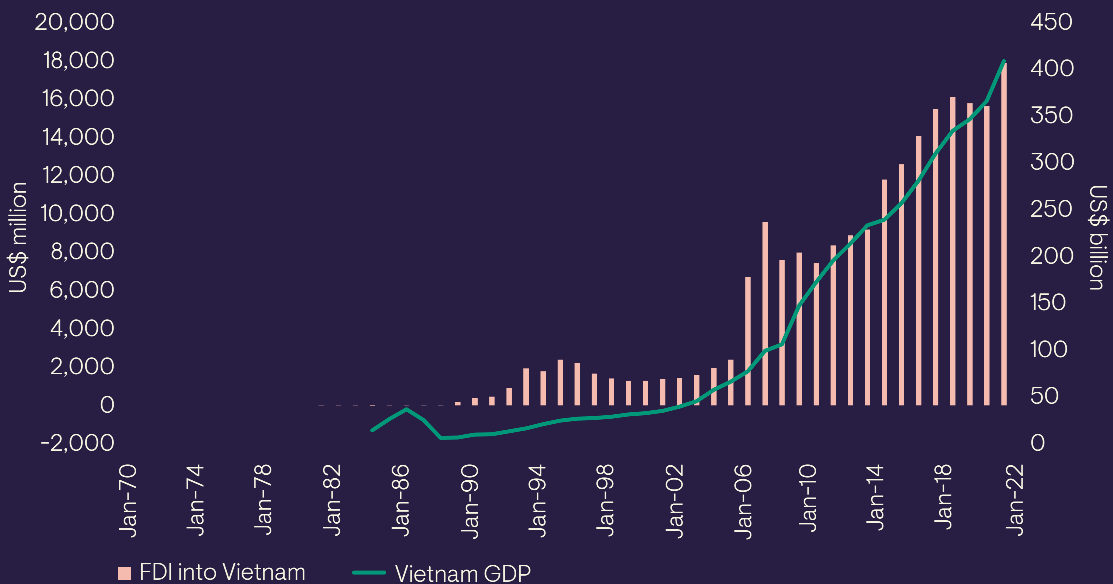
—
For further information on investment process please see the Important information section.

Is there an up-and-coming market that excites you?

Yes, Vietnam. There are several trends at play currently that make Vietnam a very interesting investment proposition. A series of astute economic and political decisions, combined with its proximity to a changing China, have propelled the world's 15th most populous country to the brink of being upgraded from a frontier market to an emerging market. Anecdotally, in many ways Vietnam is reminiscent of a younger China, say from 20 years ago, with growth primarily driven by export-led manufacturing.

Vietnam's economy really started to take off in the mid-2000s, around the same time that foreign direct investment (FDI) really started to ramp up. The economy grew nearly 3x as quickly post-2006 as it did in the couple of decades beforehand. It quickly established itself as a key exporter of high-value electronics, which accounts for c.15%[4] of total exports today. If you own a Samsung smartphone, the chances are it was assembled in Vietnam. Furthermore, Vietnam is also well placed to grab market share in the semiconductor space, which is diversifying across the region, reducing the current dependence on production in Taiwan and China where the geopolitical landscape is more volatile.

Figure 2: Vietnamese FDI and GDP



Source: World Bank, 31 December 2022.

4. World Bank & General Statistics Office of Vietnam.

Vietnam presents itself as 'open for business' and enjoys strong relationships in both geopolitical and bilateral trade terms. Vietnam finds itself in the almost unique position of having strong relationships with all three of Russia, China and the US, which in today's polarised world is an achievement in itself, from which it draws untold political and economic gains.

More opportunistically perhaps, Vietnam is another beneficiary of the redrawing of global supply routes away from China, for various reasons including diversifying reliance on a sole supplier on the back of COVID, deteriorating geopolitics and escalating protectionism. Additionally, Vietnam has plentiful cheap labour, at wages a third those of China, in close proximity to China's sophisticated and complex supply chains, so it remains an attractive destination for continued FDI.

Tying this all back to the stock market, we believe that Vietnam looks a little out of place in the Frontier index and is likely to be the next market 'upgraded' into the Emerging Markets index. While it is clearly the smaller market when compared to its ASEAN neighbours, it is catching up to markets like Malaysia and Philippines in terms of market cap[5], it is more liquid already than the Philippines and similar to that of Indonesia and Malaysia. In summary, it already meets likely size and liquidity criteria, and the only two major stumbling blocks left to sort out are settlement rules and foreign ownership limits, neither of which present as insurmountable obstacles.

We do see select opportunities in the Vietnamese market, but the number of liquid stocks is small. An emerging market economy propped up by export-led manufacturing operates very differently to one built on a more robust banking system say, so a measured approach is key. Finally, the country is still hurting from the recent property corruption scandal, so confidence may remain muted for the time being. However, the market is down a third from its 2021 peak, and while investor nervousness is still quite apparent, valuations do reflect this, and confirmation of its inclusion into the EM index, should offer additional support to valuations. Now is an interesting time to consider a small allocation.

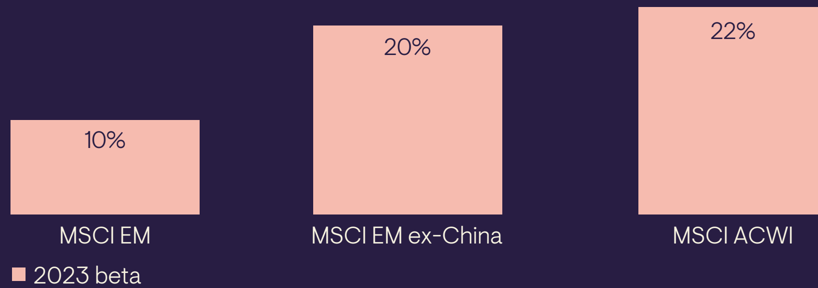
—

5. World Federation of Exchanges, 31 December 2023.
For further information on indices please see the Important information section.

Is EM ex-China the future allocation?

Investors are spending more time than in the past considering the practicalities of an EM-ex China allocation. Given where full-year 2023 returns finished, as seen in Figure 3, it's not hard to understand why.

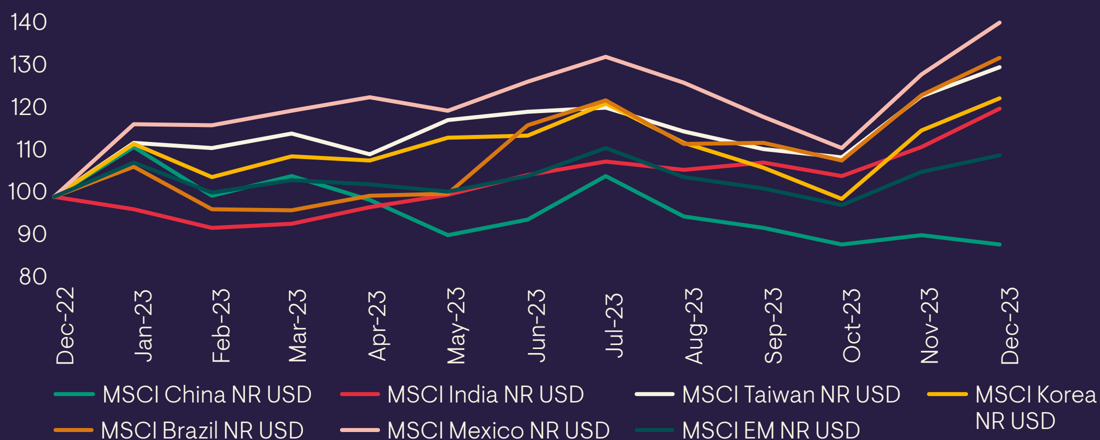
Figure 3: FY2023 index returns



Past performance does not predict future returns; losses may be made.
Source: Ninety One, MSCI, 31 December 2023.

At first glance, when we weigh up EM performance versus DM over the course of 2023, things do look disappointing. The obvious fly in the ointment was China, which failed to gather any kind of momentum. However, if we strip out China, we can see that EMs were up c.20%, only marginally behind the MSCI ACWI, which returned c.22% and without the benefit of the Magnificent 7 to drive performance.

Figure 4: FY2023 index returns[6]



Past performance does not predict future returns; losses may be made.
Source: Ninety One, MSCI, 31 December 2023.

In Figure 4, we are drawn to the breadth of returns across several key markets, which is very encouraging – 19 of the 24 EM markets were up. Of the top eight markets, which account for 88% of the benchmark, seven were up, with India, Mexico, Brazil, Taiwan and South Korea all returning over 20%. As it turns out, 2023 was a significant beta year for the EM asset class. So, if EMs can muster this kind of return without any meaningful participation from China, a meaningful risk-on shift back to China could result in a further boost to returns.

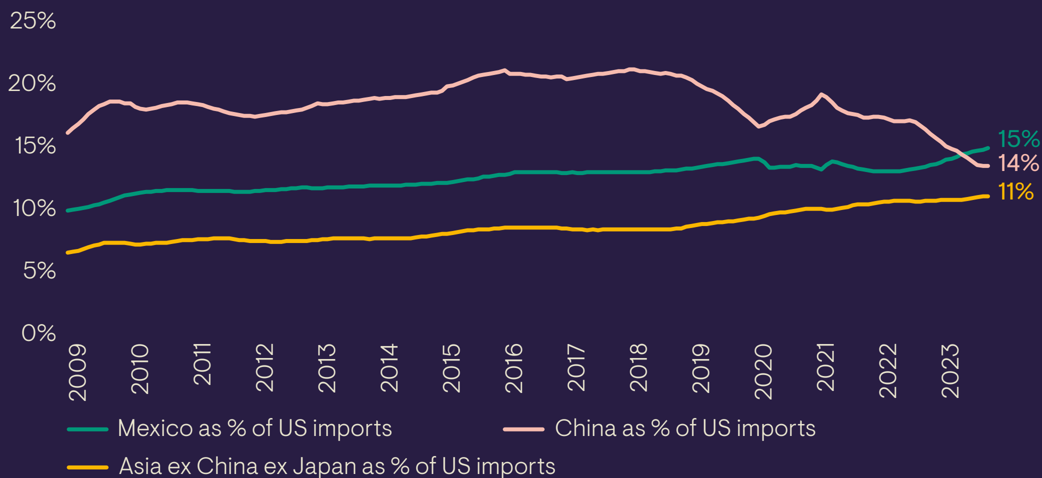
—

6. For further information on indices, please see the Important information section.

Who stands to benefit from the relocation of global supply chains?

Mexico is another point of interest, given it has both cyclical and structural supports at play. Mexico, along with India, has been a huge beneficiary of friend-shoring, at the expense of China. Figure 5 shows that Mexico has now overtaken China as the largest trading partner with the US, and current momentum would suggest China will be further marginalised in this ever more polarised world. Ever since the pandemic peak in 2021, when US consumers were stuck at home and buying Chinese-made laptops, toys, COVID tests, home exercise equipment etc., imports from China have been on a steady decline, fueled by years of political tensions. Mexico now boasts greater appeal in certain industries, such as electronics suppliers and global auto manufacturers, with industrial utilisation nearing full capacity. Structural shifts like these don't come around often, so the importance of this rebalancing to Mexico shouldn't be taken lightly.

Figure 5: Largest trading partners of the US



Source: Ninety One, Bloomberg, 31 December 2023.

Latin America can be accredited with first-mover advantage in terms of monetary tightening over the past 18 months as it sought to tame inflation across the continent. This also meant it was the first to loosen and cut rates. In contrast, most developed market central banks are yet to cut rates, although rate cuts are expected in 2024. In Mexico, rates were cut for the first time in March to 11.00%, down from a peak of 11.25%[7], where they spent most of 2023. With the year-on-year inflation figure hovering around 4.5% the real interest rate is around 6-7%. This leaves the Mexican central bank with growth levers to pull should it need to, which should provide future tailwinds for equity markets. With this in mind, our current weighting to Latin America is the largest it has been in over four years. We are also bullish on Brazil which, just like Mexico, has room for rate cuts.

—

7. Money Market Representative Interest Rates. Banxico.

Demand for a core EM manager on the up

The disparate nature of EMs is arguably their greatest strength. No two regions are travelling down the same path towards achieving their respective economic or sustainability goals. The more diverse the range of investment themes on offer at any one time the better for bottom-up stock pickers with a multi-factor investment approach like us. Investors increasingly need to navigate style rotations that have grown in frequency and magnitude across emerging markets.

There are no shortcuts here and this is why we believe a passive approach does not offer the flexibility that a core, style-agnostic active approach can to navigate this diverse mix of markets. To illustrate the complexity of the task, let us briefly examine two headaches currently facing EM investors today – the upcoming EM elections and what to do about China.

Navigating elections

Bloomberg calculates that some 40%[8] of the world – whether measured by population or GDP – will head to the polls in 2024. Of the 40 scheduled, 17 will be in EMs, with three already highlighted above in the key markets of India, South Korea and Mexico. The political and economic landscape surrounding elections will almost certainly contribute to spikes in volatility and style swings along the way. Political campaigns differ from country to country and tend to be focused on sectors either ripe for reform or key to the national interest – from social healthcare reform, to maximising petrodollar revenues, to becoming a global leader in AI. Political outcomes do not impact all sectors equally and, if anything, they can have quite polarising impacts, depending on who wins. While we do not position the portfolio towards specific political outcomes, we do keep an eye on election results and remain alert to potential opportunities. Unexpected outcomes in particular can lead to meaningful market reactions, which is ideal for an active, core, style-agnostic bottom-up stock picker versus a passive/style-focused allocation.

—

8. Bloomberg, 31 March 2023.

When to move on China

We saw from Figure 4 that China was the notable laggard in 2023 and had a material negative impact on the MSCI Index over the same period. China remains the top concern for EM investors. On the one hand you could argue that China is 'too big to ignore' and should form part of a longer-term focused allocation to EMs. There is an arguement to allocate further to China so as to benefit from a possible recovery rally. Conversely, it would be entirely reasonable to sit on the sidelines until it becomes clear how the short-term risks of the upcoming US presidential election and shifts in global supply chains will affect China.

While we have seen a rise in friend-shoring benefitting countries such as Mexico, Vietnam and India, China is so deeply embedded in the global supply chain that its role and influence on global trade will be hard to replace. Taking a more medium-term view, China aims to become more self-sufficient and focus its efforts on its own domestic market, to better insulate itself from the West.

Whatever the view or risk appetite towards China, an active approach to managing China risk is beneficial. There are times to be more cautious on China and there are times to put more risk back on the table. Whatever the prevailing sentiment, there are always pockets of opportunities, irrespective of the top-down headwinds, and that is where we try to focus our attention. For those investors who do not want to invest in China the opportunity set beyond China has never been richer.

General risks. The value of investments, and any income generated from them, can fall as well as rise. Costs and charges will reduce the current and future value of investments. Past performance does not predict future returns. Investment objectives may not necessarily be achieved; losses may be made. Target returns are hypothetical returns and do not represent actual performance. Actual returns may differ significantly. Environmental, social or governance related risk events or factors, if they occur, could cause a negative impact on the value of investments.

Specific risks. Geographic/Sector: Investments may be primarily concentrated in specific countries, geographical regions and/or industry sectors. This may mean that, in certain market conditions, the value of the portfolio may decrease whilst more broadly-invested portfolios might grow. Currency exchange: Changes in the relative values of different currencies may adversely affect the value of investments and any related income. Derivatives: The use of derivatives is not intended to increase the overall level of risk. However, the use of derivatives may still lead to large changes in value and includes the potential for large financial loss. A counterparty to a derivative transaction may fail to meet its obligations which may also lead to a financial loss. Equity investment: The value of equities (e.g. shares) and equity-related investments may vary according to company profits and future prospects as well as more general market factors. In the event of a company default (e.g. insolvency), the owners of their equity rank last in terms of any financial payment from that company. Emerging market (inc. China): These markets carry a higher risk of financial loss than more developed markets as they may have less developed legal, political, economic or other systems.

—

For further information on indices please see the Important information section.

Important information

This communication is for professional investors and financial advisors only.

The information may discuss general market activity or industry trends and is not intended to be relied upon as a forecast, research or investment advice. The economic and market views presented herein reflect Ninety One's judgment as at the date shown and are subject to change without notice. There is no guarantee that views and opinions expressed will be correct and may not reflect those of Ninety One as a whole, different views may be expressed based on different investment objectives. Although we believe any information obtained from external sources to be reliable, we have not independently verified it, and we cannot guarantee its accuracy or completeness (ESG-related data is still at an early stage with considerable variation in estimates and disclosure across companies. Double counting is inherent in all aggregate carbon data). Ninety One's internal data may not be audited. Ninety One does not provide legal or tax advice. Prospective investors should consult their tax advisors before making tax-related investment decisions.

Except as otherwise authorised, this information may not be shown, copied, transmitted, or otherwise given to any third party without Ninety One's prior written consent. © 2024 Ninety One. All rights reserved. Issued by Ninety One, May 2024.

Indices

Indices are shown for illustrative purposes only, are unmanaged and do not take into account market conditions or the costs associated with investing. Further, the manager's strategy may deploy investment techniques and instruments not used to generate Index performance. For this reason, the performance of the manager and the Indices are not directly comparable.

If applicable MSCI data is sourced from MSCI Inc. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

If applicable FTSE data is sourced from FTSE International Limited ('FTSE') © FTSE 2024. Please note a disclaimer applies to FTSE data and can be found at www.ftse.com/products/downloads/FTSE_Wholly_Owned_Non-Partner.pdf

Investment Process

Any description or information regarding investment process or strategies is provided for illustrative purposes only, may not be fully indicative of any present or future investments and may be changed at the discretion of the manager without notice. References to specific investments, strategies or investment vehicles are for illustrative purposes only and should not be relied upon as a recommendation to purchase or sell such investments or to engage in any particular Strategy. Portfolio data is expected to change and there is no assurance that the actual portfolio will remain as described herein. There is no assurance that the investments presented will be available in the future at the levels presented, with the same characteristics or be available at all. Past performance is no guarantee of future results and has no bearing upon the ability of Manager to construct the illustrative portfolio and implement its investment strategy or investment objective.

Australia
Level 28 Suite 3, Chifley Tower
2 Chifley Square
Sydney, NSW 2000
Telephone: +61 2 9160 8400
australia@ninetyone.com

Botswana
Plot 64289, First floor
Tlokweng Road, Fairgrounds
Gaborone
PO Box 49
Botswana
Telephone: +267 318 0112
botswanaclientservice@ninetyone.com

Channel Islands
PO Box 250, St Peter Port
Guernsey, GY1 3QH
Telephone: +44 (0)1481 710 404
enquiries@ninetyone.com

Germany
Bockenheimer Landstraße 23
60325 Frankfurt am Main
Telephone: +49 (0)69 7158 5900
deutschland@ninetyone.com

Hong Kong
Suites 1201-1206, 12/F
One Pacific Place
88 Queensway, Admiralty
Telephone: +852 2861 6888
hongkong@ninetyone.com

Luxembourg
2-4, Avenue Marie-Thérèse
L-2132 Luxembourg
Telephone: +352 28 12 77 20
enquiries@ninetyone.com

Namibia
Am Weinberg Estate
Winterhoek Building
1st Floor, West Office
13 Jan Jonker Avenue
Windhoek
Telephone: +264 (61) 389 500
namibia@ninetyone.com

Netherlands
Johan de Wittlaan 7
2517 JR Den Haag
Netherlands
Telephone: +31 70 701 3652
enquiries@ninetyone.com

Singapore
138 Market Street
CapitaGreen #27-02
Singapore 048946
Telephone: +65 6653 5550
singapore@ninetyone.com

South Africa
36 Hans Strijdom Avenue
Foreshore, Cape Town 8001
Telephone: +27 (0)21 901 1000
enquiries@ninetyone.com

Sweden
Västra Trädgårdsgatan 15,
111 53 Stockholm
Telephone: +46 8 502 438 20
enquiries@ninetyone.com

Switzerland
Dufourstrasse 49
8008 Zurich
Telephone: +41 44 262 00 44
enquiries@ninetyone.com

United Kingdom
55 Gresham Street
London, EC2V 7EL
Telephone: +44 (0)20 3938 1900
enquiries@ninetyone.com

United States
Park Avenue Tower, 65 East 55th Street
New York, 10022
US Toll Free: +1 800 434 5623
usa@ninetyone.com

—

www.ninetyone.com
Telephone calls may be recorded for training, monitoring and regulatory purposes and to confirm investors' instructions.
For more details please visit www.ninetyone.com/contactus

CS_619 05/2024 - MACS17402