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Beyond the headlines: uncovering opportunities in emerging markets

2025 Investment Views: Emerging markets outlook

January 2025

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The fast view

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— Emerging market economies – China, in particular – are already adapting to US trade protectionism. While Trump 2.0 raises uncertainty around the size and shape of future tariffs, any impact on emerging markets will be far from uniform. Winners will coexist with losers.

— China's authorities appear willing to underpin this important emerging market economy, reducing the likelihood of a severe downturn. However, the view from the bottom up is much more interesting, with plenty of opportunities for investors across China's transforming economy.

— While there is widespread consensus for US dollar strength in the short term, the eventual path may be more benign than feared, especially as a strong dollar appears to conflict with Trump's policy priorities.

— India's transformation story is compelling, yet equity valuations now appear stretched so a bottom-up approach to investing is vital.

— Although emerging market assets remain under-represented in investor portfolios, the diversification benefits they can bring are as relevant as ever. They also offer exposure to some major global growth themes – not least, AI.

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What does a second Trump term mean for the asset class?

Trump's trade policy is a key focus for investors in emerging markets. But beyond the alarming headlines, it is worth noting that US trade protectionism and a more aggressive stance towards China is not a new phenomenon. Many measures introduced in Trump's first administration were left unchanged under President Biden. Of course, there is much uncertainty around the eventual magnitude and focus of any new tariffs under Trump 2.0 – and whether tariffs are used as a stick, a carrot or as a genuine means to rebalance trade – but the impact on individual emerging markets is likely to be highly diverse, regardless.

The market reaction in the aftermath of the election is informative in this regard. Rather than succumbing to a blanket sell-off, emerging market performance was mixed. This highlights the huge diversity of the investment universe – in terms of economic structure, fundamental strength and trade relationships. As trading relationships evolve, some emerging market economies will struggle but others will benefit in this highly heterogeneous opportunity set.

While China looks most exposed to tariff risk, the importance of the US to China's exports is typically overestimated by market commentators. China's exports to the US have fallen by more than 25% over the past decade to only account for 14%[1]. In the eight years it has had to adapt to a change in US policy, China has been working steadily to diversify its trading relationships. Instead of fixating on events in Washington DC, investors would do well to focus on China's domestic economic policy. More broadly, a global rewiring of supply chains to increase resilience was also set in motion some years ago, and COVID accelerated it. Other emerging market economies will continue to benefit from diversification away from China, and the US cannot start to produce many of these goods immediately, but a gradual shift makes for less sensational headlines.

Tariffs and trade-related considerations aside, the new Trump administration could bring some positive developments for emerging market investors. Trump's apparent desire to bring to an end various conflicts – namely in Ukraine and the Middle East – could remove the geopolitical risk premium priced into many emerging market assets.

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1. Ninety One, Bloomberg, 31 December 2023.

What's the outlook for China?

Even if the China growth story is no longer particularly exciting and a growth miracle appears unlikely, we think China's economy today is somewhat more underpinned – with the government essentially showing its willingness to provide a safety net and remove some potential downside risk. While stimulus measures announced towards the end of 2024 were met with some disappointment – notably among the fixed-income investment community – their inclusion of vital support for China's property market marked a line in the sand. That has taken some of the more negative risk scenarios off the table, which is good news for all emerging market economies.

All that being said, while many market participants continue to focus squarely on the macroeconomic picture, the view from the bottom up is a lot more interesting. There are plenty of compelling Chinese stocks to invest in, typically relating to three key shifts taking place in China. Firstly, Chinese consumers are trading down from luxury labels, favouring more value products to save money. Secondly, China's ageing population means that demand for healthcare, pensions and life insurance is rising. There are already compelling investment opportunities to be found in companies catering to all of these. Finally, in recognition of today's different operating conditions, many companies in China are restructuring, reducing costs, boosting earnings and actually paying a lot more back to shareholders in terms of buybacks and dividends.

Our full outlook for China can be found here.

How concerned should investors be about US dollar strength?

The consensus case for US dollar strength – relating to higher interest rates in an economy that has performed exceptionally well; the potential weight of tariffs on other currencies; and the fact that major currencies like the euro are not posing any real challenge – appears compelling in the short term. However, the extent and duration of any potential dollar strength-related headwinds may prove more benign than many fear, and typically when markets are making a one-way bet they have been proven wrong. Furthermore, a strong dollar is diametrically opposed to some of Trump's key policy ambitions: to rebalance trade and rebuild the Rust belt. In short, looking past the noise, there are reasons to question the assumption that the dollar will remain exceptionally strong for a protracted period.

Where does a pivotal year leave Indian assets?

In the next three to five years, India could overtake China to become the largest emerging equity market. This is a transforming economy, with a range of government policies implemented over the past few decades now feeding through into economic growth and company profits. Perhaps one of the most significant, but least talked about, is the initiative to give everybody an identification number (Aadhaar), effectively allowing 500 million people to become economically active; the scale of this rise in economic participation is staggering.

However, the more visible and tangible transformations in India – a country that's building 45 kilometres of road every day, creating its first high-speed railway, undertaking a variety of metro projects, and building new ports, etc. – have not gone unnoticed by investors. India's equity market is now trading at a growth premium; expectations are high, and valuations look stretched. Yet there are some great companies to invest in – should a correction take place in the equity market in 2025, valuations should become more reasonable. In the meantime, investors need to be highly selective and avoid getting caught up in the euphoria.

Turning to India's fixed income market, the country's inclusion in the flagship emerging market local bond index in 2024 underscores the maturity of the asset class. Significant evolution over the past 20 years has created a higher quality, more diverse and less volatile market, with India's inclusion a welcome development in that regard.

What policy moves should investors expect across emerging markets?

Over the past few years, prudent and credible policymaking have put many emerging market economies in a good position. Proactive rate hiking meant emerging market central banks were able to quickly anchor inflation expectations. And if there's one thing the multitude of election outcomes taught us in 2024 – when many incumbents lost power – it's that if policymakers don't get a grip on inflation, there's a heavy political price to pay. In the past few years, much of the resilience seen in emerging currency markets has been thanks to more orthodox policymaking in emerging market economies.

On the fiscal policy side, too, there are some great examples of sound economic stewardship across the emerging market investment universe, with Argentina now an unlikely poster child in this regard (fiscal discipline and reform is turning around the Argentine economy). While there are certainly exceptions, credible policymaking and fiscal reform is a clear trend in emerging markets, and we expect it to continue. Contrast that with glaring fiscal imbalances in some of the world's biggest, most developed economies (with the US economy looking increasingly vulnerable from this perspective), and the world order appears to have been turned on its head. There are no signs of this reversing in 2025.

Over the past few years, volatility and other characteristics of developed bond markets increasingly resemble those typically associated with emerging markets. Government bonds in the likes of Germany, France, and the US have cheapened (government borrowing costs have risen) making other parts of their credit market look much less attractive on a relative basis. That's not the case in emerging markets.

How relevant are emerging markets to investor portfolios today?

Emerging market assets – whether equities or fixed income – are typically under-represented in investors' portfolios. Yet they continue to offer investors useful portfolio diversification benefits, especially today.

Emerging market equities can help to diversify against the highly concentrated US equity market within a global equity allocation, and at an attractive price (with the weighted average P/E ratio of the MSCI EM index at 12x compared with 19x on the MSCI World index[2]). They are offering a cheap alternative and access to interesting bottom-up opportunities, with some real sources of growth and exposure to key structural themes - some global, some country-specific. Take AI for example. Asia is the world's AI factory, and if AI becomes as big as we think it might, much of the associated manufacturing would take place there. That makes suppliers to NVIDIA, for example, look very interesting, while several of them are trading at a fraction of NVIDIA's valuation.

Similarly, the low correlation of emerging market fixed income asset classes is easy to overlook given all the other noise surrounding the asset class. The next 5-10 years are likely to look very different to recent history, with a new political landscape and potential for global inflation to persist; the diversifying potential of the asset class will be particularly valuable for investors. Furthermore, many investors are simply unaware of how useful the asset class can be for portfolios, with its nice balance of cyclical and defensive components. As with emerging market equities, valuations remain attractive.

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2. Factset, 31 December 2024.

Which other equity markets look most interesting?

In the coming years, Chinese manufacturers could see a significant growth opportunity in Africa and Asia. These are huge markets that are growing considerably faster than Europe and the US with much less capacity and far lower competition. Companies that position themselves to benefit from this shift look poised for strong growth.

Similar to India, significant change is happening fast in the Middle East, both economically and socially. For instance, in Saudi Arabia, the number of women working has doubled in the last five years – reshaping the economy and creating an array of interesting investment opportunities.

Elsewhere, a range of very diverse economies are benefiting from supply chains resetting and shifting around. For instance, Eastern Europe has become an attractive destination for German and French companies to outsource to. In Asia, ASEAN[3] markets are benefiting from companies moving out of China and looking to diversify some of their risk. Investors can find plenty of interesting opportunities in this category.

Although it's going to be increasingly difficult for China to sell an electric vehicle into the US or Europe, taking a pan-emerging market view, there is significant growth potential in another sector: technology. Between 35% and 40% of the market cap in emerging markets is now technology related in one form or another. The tech sector is what has driven the US equity market in recent years; a similar phenomenon could drive emerging markets going forward, with the potential to take many market participants by surprise.

Crucially, equity investors can access these investment opportunities at compelling valuations.

Where are the opportunities within fixed income markets?

In emerging market fixed income portfolios, the short-term outlook – reflecting growth-friendly policy in the US and the potential for more expansionary policy in China – favours higher carry and higher yielding markets. Investors should be selective in their FX market positioning given the uneven impact of potential tariffs and uncertainty around these. In local rates markets, there are still plenty of economies where real (inflation-adjusted) interest rates are exceptionally high, creating a positive outlook for bond prices.

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3. ASEAN - Association of Southeast Asian Nations.

The local debt markets of several frontier countries also look attractive. These economies have undergone substantial domestic policy shifts over the last year and their debt offers investors relatively high yields and low volatility compared with more established emerging markets. Furthermore, this debt is typically less correlated to broader moves in US Treasury yields.

Among emerging market corporate debt issuers, yields look compelling across the ratings spectrum as the outlook for company fundamentals appears benign, with default rates expected to be low thanks to manageable levels of debt and refinancing risk, even in the event of a punitive tariff regime. While credit spreads are historically tight (like in all credit markets), a bottom-up investment approach still reveals plenty of individual opportunities that offer attractive value – these exist across the ratings spectrum and across geographies. From a regional perspective, while corporate bond valuations in some Asian markets look quite expensive, pockets of value can still be found, particularly in India where companies are benefiting from positive macroeconomic growth stories. Elsewhere, we believe that there are attractive opportunities in parts of Latin America, including Brazil and Colombia, in sectors such as oil & gas and metals & mining. And while Mexico could come under pressure from tariffs and immigration policy from the Trump administration, we believe the country still offers interesting opportunities in domestically oriented sectors such as utilities and banking, which are relatively insulated from this dynamic. Considering the global opportunity set, the utilities sector looks compelling from a broader perspective given its defensive nature and its exposure to renewable energy, which will be supported by the global transition towards net zero.

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CS_737 01/2025 - MACS18396