December 2020

Ninety One

Previously Investec Asset Management

A broader market leadership in 2021

Archie Hart
Portfolio Manager

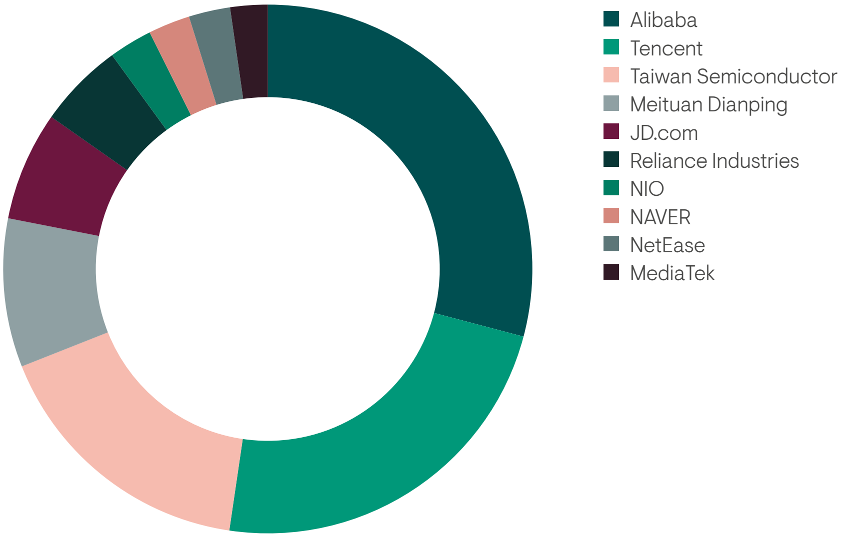
The fast view

- Narrow market leadership defined emerging market equity performance in 2020, both from a sector and regional perspective.
- The broadening out of market performance seen in the third quarter could continue in 2021, as the market's focus turns to recovery.
- There could be less divergence between quality growth and value returns, with some cyclical sectors showing better operating momentum.
- However, investors should expect some volatility to remain in 2021 around the US presidential handover, the vaccine introduction and spikes in COVID cases, while debt overhangs and rising populism are obstacles for some emerging markets.
- The pandemic has overshadowed some positive developments in emerging markets, which show continued progress on promised reforms as well as new commitments around carbon neutrality.
- We expect a much more normalised market environment in 2021, where company fundamentals are appreciated.

Few winners in an extraordinary year

2020 was an extraordinary year for markets across the globe and emerging markets were no exception. Over the last 20 years, there have been six big volatility events affecting performance in markets, two of which – the COVID-19 pandemic and US election – occurred this year. This drove an extremely narrow market leadership and some of the highest correlations we have ever seen in emerging markets. Only three out of the 26 regional markets – China, South Korea and Taiwan – made gains in the first nine months of the year. This outperformance was driven by these economies' ability to manage themselves out of the coronavirus pandemic. Similarly, only four out of the 11 sectors delivered positive performance – health care, communication services, technology and consumer discretionary – with eight out of the top 10 stocks related to technology or the internet. These top ten companies drove all the emerging market return over the first three quarters (Figure 1), leaving around 1,400 names which performed poorly[1].

Figure 1: Technology- and internet-related stocks dominate market returns in 2020



Source: Factset, MSCI Emerging Market index returns, 30 September 2020.
This is not a buy, sell, hold recommendation on particular securities.

Markets became optimistic on positive signs toward vaccine development and green shoots of economic recovery, which drove a broadening out in market performance in the third quarter. Five out of the 26 markets outperformed while most of the sectors delivered positive returns. We expect this broadening out in performance across sectors and countries to continue in 2021 alongside less correlation in markets, as economies recover from the pandemic. Those hardest-hit economies, including countries in South America and South East Asia, may see a rally as they recover further.

—

1. Source: Factset, MSCI Emerging Market index returns, 30 September 2020.

A value comeback?

With light at the end of the COVID tunnel, there have been rallies in value stocks, but we don't believe all value stocks and sectors will be off to the races just yet. Perhaps, there will be less divergence between quality growth and value performance and a much broader market in general. However, there is still positive operating momentum in the winners of 2020. If you look at technology- and internet-related stocks, forecasts for 2021 earnings growth are up to 20%. Earnings upgrades are beginning to come through in cyclical stocks, with analyst expectations too pessimistic in some cases. There may be high growth in some rebounding areas, such as materials, transport, travel and consumer discretionary. Investors should be selective and focus on company fundamentals, as some rallies could be short lived and driven by sentiment. In terms of portfolio positioning, we have taken some exposure out of technology and re-allocated it to those areas which have lagged and that have significant recovery potential, such as banks, some consumer recovery stocks and airports.

However, we believe there will be a lot of near-term market volatility over issues such as the US presidential handover, the vaccine introduction and spikes in COVID cases. In the second half of 2021, we expect the markets to settle more as the world turns its focus to a post-COVID world and the nitty gritty of how companies and countries are really faring. This should be a conducive environment for stock pickers like ourselves.

Where are the potential risks?

More optimism does not necessarily mean that markets will be less discriminating. 2020 saw a number of countries reschedule their debts in 2020, including Zambia, Ecuador and Argentina. There will be emerging market countries that struggle to balance their books in 2021. The second order impacts of the pandemic on economies are coming through, with the outbreak exposing fractures and inefficiencies in economies. This is reflected in protest movements spreading across parts of Latin America and Eastern Europe. Peru has seen three presidents in a week, while Chile has decided to rewrite its constitution to what will almost certainly be less business-friendly terms.

The advent of COVID-19 has stimulated a rush towards populism and such political instability is usually accompanied by currency volatility. Historically higher interest rates have cushioned volatility in more troubled countries, but record lows in interest rates globally means such protection is absent. This is a risk if things go wrong, but it can also work as a positive. In Turkey, after interest rates were hiked to control inflation, a strong stock market and currency rally followed. We believe divergence in emerging market equity performance will be a feature of markets in 2021, partly as the focus turns to the withdrawal of stimulus.

The coordination in COVID-related economic impacts crippling developed markets has been matched by their extraordinary stimulus response, which we will have to wean ourselves off eventually. This compares to less stimulus seen in emerging markets and so we expect that there will still be divergence between emerging and developed markets, presenting opportunities for investors to secure diversification in portfolios.

Positive developments in EM

The dark cloud of pandemic news has also obscured some of the positive developments in emerging markets. The Brazilian development bank has sold down holdings in listed companies, which is positive for market development. Financial reforms in India and China have continued. China, Japan and Korea have all committed to carbon neutrality; a notable positive given they contribute a significant part of global emissions. 2021 presents an opportunity for the market to focus on such individual developments that will be key to returns next year and beyond. The renewable energy transition is a multi-decade long trend and we have a number of companies that are well positioned to benefit from this.

As the largest part of the EM universe, China's trajectory will be key to emerging market investors. Markets will be focused on the new US president and corresponding relationship with China. We believe the new administration does not change the status quo, as there is broad bipartisan support in America to be tough on China. While we expect the new president to be tough, we believe he will be more practical, pragmatic and rational in action. If the US-China temperature cools, that should be relatively positive for emerging markets as markets respond well to more stability. Outside the US, China has had a busy year geopolitically. Nevertheless it has progressed towards its promised economic reforms despite geopolitical headwinds; China's economy has rebounded vigorously from COVID-19 and so it will be interesting to see how it adjusts its policy to the new presidency in the US.

Normalisation on the horizon?

In our view, 2021 represents some uncertainties, but also significant opportunities for investors as the world begins to see past the pandemic. After the seesaw of 2020, we expect a much more normalised market environment with broader market leadership, which should be supportive of balanced approaches such as 4Factor. We believe that with such normalisation markets should again start to appreciate company fundamentals.

General risks. The value of investments, and any income generated from them, can fall as well as rise. Where charges are taken from capital, this may constrain future growth.

Specific risks. 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.

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

Botswana
Plot 64511, Unit 5
Fairgrounds, Gaborone
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

Italy
Palazzo Toschi Corneliani
Corso Venezia 44
20121, Milan
Telephone: +39 02 3658 1590
enquiries@ninetyone.com

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

Namibia
First Floor, 6 Thorer Street
Windhoek
Telephone: +264 (61) 389 500
namibia@ninetyone.com

Singapore
25 Duxton Hill #03-01
Singapore 089608
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
Grev Turegatan 3
114 46, Stockholm
Telephone: +46 8 502 438 20
enquiries@ninetyone.com

Switzerland
Seefeldstrasse 69
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

Important information

This communication is for institutional 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. 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.

CS_200_11_2020