Emerging Markets Equity

Market context

After the volatility of August, September saw markets advance, helped by a shift in central bank policy towards monetary easing. The US Federal Reserve cut interest rates, as did the European Central Bank. Meanwhile, employment data remained reasonably reassuring and inflation prospects improved as oil prices slid. At the end of the month, China unveiled its most substantial stimulus package since the pandemic to boost its ailing economy.

The Chinese stimulus, the prospect of faster interest-rate cuts and gains in risk-asset markets provided a positive backdrop for many commodities in September. The price of gold touched new highs in the month, supported by the shift into a declining interest-rate cycle and a desire for perceived safe-haven investments amid geopolitical tensions in the Middle East. Among industrial metals, iron ore and copper rose on the announcement of fresh support for the Chinese economy.

Equities saw a shift in performance away from the large technology stocks that had dominated performance for much of the last two years and towards a broader spectrum of the market. Over the month, most sectors rose, with the exception of energy stocks and technology. The prospect of a better economic outlook lifted consumer discretionary and materials stocks. Relief for the Chinese property sector helped the real estate sector outperform.

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Performance

The Strategy underperformed the MSCI EM Index over the month, gross and net of fees*.

Stock selection in the consumer discretionary sector was the biggest detractor from performance. The dramatic rally by Chinese stocks at the end of the month meant that not owning Chinese internet giants PDD Holdings and JD.com and being underweight Alibaba Group were all among the largest detractors from relative performance. Conversely, weakness in markets like South Korea and India that had previously done well meant that stocks like Samsung Electronics and PB Fintech saw profit-taking.

More positively, the Chinese online business Meituan was the leading contributor to performance. In addition to the stimulus bounce, it posted a strong beat in its Q2 results and announced a further US$1 billion share buyback plan at the end of August, which was a tailwind through September. In financials, AIA Group and Ping An Insurance also benefited from the positive sentiment towards Chinese equities following new stimulus package. The latter any reported strong results during the month, ahead of analyst expectations and alongside new strategic initiatives which further reinforced investor sentiment. Similarly, Hong Kong Exchanges and Clearing was boosted by strong trading volume as investors sought to increase their Chinese positions. Partly as a result, stock selection in the financial sector was a significant contributor during the month.

*Where performance is gross of fees, returns will be reduced by management fees and other expenses incurred. Net performance is net of highest institutional segregated portfolio management fee.
Not all securities held have been discussed. For further information on how the overall strategy performed during the period covered, please reference the relative performance noted in the Performance review section.

Past performance does not predict future returns; losses may be made.

Outlook

In the first nine months of 2024 emerging equity markets have delivered a +17% return, which was presumably a positive surprise for the many cautious observers of the asset class. The drivers for most of that period were the technology sector (+19%) and India (+25%). However, September delivered a major surprise, with Chinese policymakers delivering a concerted effort to reverse the deflationary narrative and stimulate the economy, triggering an explosive 24% rally in Chinese markets (most of that coming in just the last week of the month). Looking forward, the longevity of the China rally is dependent on Chinese policymakers continuing to act with vigour to enact more expansionary fiscal policy, reduce the substantial tail risk represented by the property market and become more supportive of private enterprise. As such, the recent more determined stimulatory actions of the Chinese government represent only the beginning of what is required. However, a late beginning is clearly better than no beginning at all.

Aside from the very positive news emanating from China, there remains much uncertainty in the broader outlook. The two most obvious areas of potential risk lie in the US Presidential election and turbulent geopolitics (not least in the Middle East). Neither issue is unusual, however, and both are likely to reach some sort of resolution over the next few months. How worried should we be? The late great John Templeton said, “Bull markets are born on pessimism, grown on scepticism, mature on optimism and die on euphoria”. Low valuations and heightened risk aversion imply we are currently somewhere between “pessimism” and “scepticism”, implying much of the obvious risk is so – well – obvious that it has already been priced by the markets.

Looking forward into 2025, we believe one scenario might simply be that we are at the beginning of a “great normalisation” where we could be leaving an era of pandemics, hyper-active central banks, and elevated geo-political risk behind and looking forward to the sort of environment where stock-pickers can focus on the fundamentals of great businesses with fewer distractions from the macro environment. Any normalisation would be very positive for emerging market equities, but perhaps less so for developed markets which have benefited from a strong tailwind of extremely low interest rates and lax monetary policy for 15 years. Without those tailwinds we believe returns between developed and emerging markets should be more correlated.

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