



## INSIGHTS WEBINAR SUMMARY

# Unlocking Opportunity in Emerging Markets After the Pandemic

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## State of Recovery and Macroeconomic Outlook in Emerging Markets

- Ernest Yeung noted that emerging market (EM) stocks sold off aggressively at the beginning of the coronavirus pandemic on concerns that their health care systems would be unable to cope.
- The response to the health crisis was mixed across the EM world. For some, like in North Asia, lockdowns were enforced and cases were low. But economies in countries like India and large parts of Latin America struggled to cope with lockdowns.
- Ernest noted that those countries that were unable to shut down potentially present more compelling investment opportunities, in part because their markets were weaker and in part because their path to herd immunity may surprise investors due to broader exposure to COVID-19 (the disease caused by the coronavirus) and younger demographics. In fact, many of these countries—India, Brazil, and Mexico, to name a few—are nearly back to pre-pandemic production levels. North Asia counterparts do not have the immunity (and are awaiting vaccination), which could slow their recovery. This shift in prospects could reignite a broader interest across the EM landscape over the next 12 months.

## Central Banks and Policy Response

- There has been a shift in developed markets tactics—moving away from monetary policy—in favor of direct-to-consumer “helicopter money.” Historically, monetary policy had only assisted corporates and asset owners. Ernest believes that “helicopter money” will foster meaningful global economic growth in the short/medium term because it goes to consumers and creates a multiplier effect on the economy.
- He also noted that since EMs lack the fiscal firepower of developed markets, most of their fiscal balance deterioration is attributed to cyclical factors, mostly tied to their weaker economies. Fortunately, their fiscal balances should improve this year as their economies recover.
- With respect to capital expenditures (capex), Haider Ali noted that prior to the pandemic, capex in EMs had been falling, citing shortfalls in free cash flow and shareholder pressures to return capital. However, he anticipates a reversal of this, citing supply shortages and the need to invest.

## Growth Versus Value and COVID-Off Stocks

- Ernest noted that promising vaccination efforts may provoke a trade-out of “stay-at-home” stocks that benefited from the pandemic (technology, e-commerce, communication services), with investors reallocating capital into shares of companies that will benefit from reopening of economies.
- We have witnessed somewhat of a reversal in earnings estimates since the news on vaccines. Value-oriented stocks, and those more exposed to a cyclical upswing, have been revised higher. Yet the valuations for many of these companies are trading near 20-year lows. These stay-at-home beneficiaries may struggle with year-over-year comparisons.
- Today, a significant portion of exposure to EM assets is allocated to strategies that are core or growth styles. As the recovery continues and given the disparity between these extreme valuations, value-oriented strategies may stand to benefit.
- Haider pointed out that many “old economy” sectors (airlines, telecoms, capital goods companies, transportation, and financials) have been trading near trough levels and, therefore, could provide upside potential.

## EM Currencies Relative to the Weakening U.S. Dollar

- Ernest commented that assessing the direction of the U.S. dollar is the most important consideration today for any asset allocator.
- Helicopter money could persist in the U.S. for years under President Joe Biden’s and Secretary of the Treasury Janet Yellen’s leadership, and a widening fiscal balance has historically correlated with a weakening U.S. dollar.
- Over the next two years, the outlook for EM currencies is positive. The deterioration of gross domestic product levels for EMs over the last year was largely cyclical, and many countries like Brazil and South Africa are experiencing a current account surplus. Fundamentals and the real interest rates for EM countries are generally trending positive.

## Navigating China’s Regulatory Landscape

- Haider stated that greater government scrutiny on technology and e-commerce companies was a global trend, and not just limited to China. These companies have become such a regular component of daily life that they warrant increased attention.
- On China, specifically, Haider reminded listeners that China is a command economy and the government wants to be actively involved in regulating the lives of its people.
- He cited historic examples of increased regulation in both online gaming and education that had a short-term negative impact on stock prices. However, very quickly the strongest companies learned to adapt, and their stocks rebounded.

## Identifying Forgotten Opportunities in Emerging Markets

- The strong rally in EMs last year was led by a few select industries and companies, largely mega-tech. As EM economies recover, the opportunity to participate in growth beyond these narrow areas is very attractive for active investors.
- Ernest is positive on the financials sector and highlighted that disparity in banks, where some were trading at near-record lows while others were back at pre-pandemic levels. This disconnect presented an opportunity to build an overweight in the sector and buy quality names at very attractive valuations.
- More generally, Ernest is focused on identifying quality growth stocks that have sold off indiscriminately during the pandemic but remain well managed and present attractive valuations.
- In particular, he cited airports and cosmetic companies as just two of the “going out” areas of the market that were compelling from both a business model perspective and a valuation standpoint.

## ESG Evolution

- Haider spoke on the team's approach to environmental, social, and governance (ESG) issues in emerging markets. He shared how evaluating the ESG merits and concerns of sectors and companies is an integral part of their research process, and not something they use just as a negative screening tool.
- ESG analysis helps the team avoid “value traps.” Companies with horrendous corporate governance histories can often be a sign of a value trap, and ESG insights help the team avoid those.

## EM Risks and Concerns

- Ernest shared how important stable energy prices were for production chains in emerging markets. Oil has a major impact on many EMs, both on an import basis for countries like Brazil, China, and India and also for export nations like Argentina, Russia, and Saudi Arabia.
- He also shared his concerns over the valuations in some parts of the market, namely mega-tech companies (a major part of the index). Large retail investor involvement, multiple expansion, and crowded initial public offering subscriptions are signs of some “irrational exuberance” and a potential asset bubble.

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