# Global Matters Weekly

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## Emerging Opportunities

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2020 witnessed some of the toughest challenges – be it social, economic or political – that most of us have ever experienced. Around this time 12 months ago, the Covid-19 pandemic was gathering momentum, particularly in Asia before it spread further afield, and soon enough the world went into lockdown. As we slowly emerge from the shadow of the pandemic thanks to vaccine breakthroughs, mobility and global economic growth should gradually increase. Emerging markets (EM), led by the Asian powerhouses (primarily China, South Korea and Taiwan), are likely to lead the recovery helped both by them being the engine of global growth but also having managed the pandemic better than peers. Emerging markets outperformed global developed equities in 2020 for the first time in three years: could this be a sign of things to come?

The evolution of emerging markets has been significant over the past few decades, creating a much broader set of potential opportunities for investors. Both equity and debt markets have become much broader and deeper and EM indexes more diverse, thereby creating a much richer and more robust opportunity set. There are many other dynamics that emerging markets can benefit from, such as the growth of the middle class, advances in technology and improving corporate governance, which together are likely to encourage more flows into the region.

In the current low growth world, emerging markets offer much promise relative to their developed market peers. GDP growth is likely to outpace that in developed markets, particularly within the Asian region.

With eye-popping valuations in some parts of the US equity market, the question we receive from many investors is, are there any bargains to be had? We believe there are pockets of value such as cyclical areas of the market (traditional value stocks) which still have significant upside from here. Emerging market equities represent another area with exciting return potential as valuations are still reasonable despite strong performance in recent months. Solid and improving fundamentals led by the Asian countries (which account for almost 75% of the MSCI EM index), along with an increasingly positive focus on ESG issues and supportive flows into the regions, together produce a bright picture for emerging markets in the years ahead.

In the current environment of low to negative yields in much of developed bond markets, investors with a focus on income would be wise to look further afield, with emerging market debt (both hard and local currency) offering a decent yield premium. This yield advantage should help to insulate emerging market bonds from rising bond yields elsewhere should global growth recover as anticipated. Whilst spreads relative to US Treasuries have tightened significantly, we believe there is room for more compression as global economies recover. The potential for a weaker US dollar provides another tailwind for the asset class.

Exposure to emerging markets adds diversification, as it generally an anti-dollar trade which serves to balance the bias most portfolios exhibit as a result of owning dollar rich assets in the form of treasuries and stocks.

So how can we tap into this potentially faster growing and higher yielding region? Whether you are considering stocks or bonds, emerging markets offer a compelling opportunity as the global economy recovers. The next decision is to take the "active" or "passive" route: whether to buy a cheap passive fund or seek out the expertise of an active manager. I think there are plausible arguments on both sides, however emerging market exposure is not without risk. As with any investment, this selection choice and associated risk is best mitigated with thorough due diligence by a specialist investment team and combining this with a strong and robust portfolio construction process.

We are aware of the many risks that lie ahead, not least the roll-out and efficacy of vaccines and their availability to people living in emerging markets who are the engine behind this growth. We are very mindful of the strong gains delivered by risk assets in recent months leading to elevated valuation in some parts of the broader market. However, we see a rotation into value sectors and regions as offering the best longer term recovery potential, and emerging markets today merit increasing attention as part of your overall portfolio construct.


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Important notes