A focus on emerging markets

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The evolution of emerging markets

MSCI launched the emerging market (EM) index in 1988. At that time there were 10 countries in the index, making up 1% of the world market capitalisation. Today, there are 26 countries represented in the index which now makes up 10% of world market capitalisation. We also see a very different group of countries in the index today. Portugal has left; Greece left, but is now back in; Malaysia was at one point the biggest (29%) country in the index; China was at 0% and now represents 41% of the index. The emerging market countries are constantly developing and moving, they're not a fixed group. They're still cyclical, but less so, because the biggest countries in the index are less cyclical.

We look for industries with a return on investment which then gets re-invested. This leads to a rising income per person. The wealth effect kicks in and you have a strong domestic economy as well as a strong export economy. This is obviously much more pronounced when you're dealing with a big player such as India or China.

When looking at EM investments, we consider questions such as whether the real money supply is growing quicker in EM vs DM (developed markets), where are we in the cycle, valuations, excess liquidity, what commodity prices are doing, what the US dollar is doing, etc. We use this information to inform whether we think a cyclical asset will perform over the long term or whether it's a tactical investment.

Emerging markets – investing for long-term structural growth

We've noted that the wealth effect results from a rising income per capita. Even a small percentage increase can have noticeable effects. For example, if income distribution or income per head grows 15% in two years, we can see the tremendous effect this has on companies such as car manufacturers. The number of people in China who can afford a certain car, doesn't only increase by 15%, it doubles. In a densely populated country like China that translates into huge numbers.

We also look at things like the number of patents that have been granted, AI investment and research papers written.

In terms of stock examples, Taiwan Semiconductor is an example of a stock that has a strong competitive advantage – companies such as Apple, Alibaba and Disney all need their product.

It's not just about technology though – we've also invested in a company, Midea, that makes kitchen appliances. They've invested and grown faster than their competitors. They took domestic market share and then took on their rivals, and then became a global player.

In addition to EM being a different mix of countries to previous decades, some of the countries themselves are developing rapidly – for example, introducing different sectors and stocks.

We anticipate China will remain an emerging market for quite some time. This is because they still have a middle-income level per head. To move out of EM, they need to raise their per capita income level.

China has a very different approach. It has advantages in that its monetary policy is quite tight and in many ways it was ahead of the rest of the world in its response to the COVID pandemic. The bond market is huge in China – it has attracted the attention of sovereign wealth funds as well as their own investors.

We believe emerging markets offer more than cyclical trade opportunities. We aim to identify areas where we see potential for long-term structural growth.

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