

EMERGING MARKET EQUITIES 2023 OUTLOOK

HEADWINDS BECOME TAILWINDS



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Emerging market (EM) equity investors haven't had much to shout about for the past 1-2 years. This follows on from what has been described by some as a "lost decade" for the asset class relative to US equities.

However, things are now improving and we believe we are entering a 12–24 month recovery in EM equities, predicated on a number of cyclical and structural drivers.

CYCLICAL CATALYSTS:

1. CHINA'S REOPENING

The significance of China's reopening is hard to overstate for EM equities. The restrictions during 2022 had a hugely negative impact on supply chains, employment and sentiment. As activity normalises with the relaxation of restrictions, at the same time as the regulation of property and platform

company sectors eases, this should provide significant support for China equities and EM more broadly.

2. SLOWER GROWTH IN THE US

US growth and the resulting US equity market strength has been a critical factor in EM's "lost decade". In terms of investment flows, when the US is doing well, global investors tend to gravitate towards it. It's also the safe-haven market that investors retreat to when global growth retrenches significantly.

What EM equities need to outperform is a period of US growth that is not too far above or below the long-term average, which is what we expect to begin in Q1 2023 and continue for around 12 months.



CONSENSUS ESTIMATES POINT TO EARNINGS IN EM OUTPACING THOSE IN DM THROUGH 2023 AND 2024.

3. STRONGER GDP AND EPS GROWTH IN EM

Slower growth in the US and developed markets (DM) needs to take place at the same time as GDP growth in EM picks up. We expect this to occur in 2023, driven in large part by China's reopening. This higher GDP growth should then translate into stronger earnings growth for EM corporates, making them more attractive than their DM counterparts.

Consensus estimates point to earnings in EM outpacing those in DM through 2023 and 2024. Importantly, the consensus is arguably still too optimistic for the US, whereas expectations for EM have experienced a protracted down-cycle that is now seeing companies beating these lowered expectations.

4. PEAK IN PACE OF FED TIGHTENING

Higher US interest rates and correspondingly higher US Treasury yields have been a significant headwind for key EM sectors such as

technology, as well as for our 'growth at a reasonable price' (GARP) investment style. They have also fed into US dollar strength. As the pace of tightening slows, these negatives should reverse, providing a more supportive backdrop for EM equities.

5. WEAKER USD

The strength of the US dollar, which was until very recently sitting at a 20-year high, has been a notable headwind for EM countries and equities during 2022. When this trend reverses, it should provide a significant tailwind for EM.

6. SUPPORTIVE VALUATIONS

EMs are unarguably cheap, as they have been for some time, however, the relative valuation argument vs. DM is perhaps more compelling. With many EM stocks trading at distressed levels, this provides an attractive risk/reward proposition.



7. INVESTOR CAPITULATION

Widely watched as a way of timing inflection points in asset classes, this has largely been satisfied as 2022 outflows matched or came close to historical peaks. Claims that parts of the asset class (i.e. China) were un-investable, made more than once this year, have signalled near-term market bottoms each time.

On top of these cyclical factors, EMs are also benefiting from multiple longer-term structural drivers, including:

- India's continued development and urbanisation.
- The continuation of EM financial inclusion (a key theme for us) broadening financial access and opportunity.
- Further productivity growth.
- A global investment cycle based upon the ongoing re-shoring of production to defend against future supply chain disruption.

At this stage, we don't suggest these structural factors are enough to propel EMs into another multi-year super cycle, rather they provide additional support for the asset class's long-term growth outlook and marry with the cyclical catalysts described to provide an exciting backdrop heading into 2023.

It's also worth noting, the last time we saw such a supportive set of factors was 2016–2017, when the MSCI Global Emerging Markets and the MSCI AC Asia ex-Japan Indices both climbed by over 40%. As such, we head into 2023 with a far more constructive view on the EM equities asset class.



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