3 REASONS TO INVEST IN EMERGING MARKET EQUITIES NOW

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Asset Management

EMERGING MARKETS BEGIN TO TAKE A LEADERSHIP ROLE IN THE WORLD AGAINST A BACKDROP OF CONTINUED STRONG FUNDAMENTALS

ROUND-UP WITH DANIEL TUBBS, HEAD OF GLOBAL EMERGING MARKET EQUITIES

1 HOW ARE EMERGING MARKET COMPANIES LEADING THE MARCH AGAINST THEIR DEVELOPED MARKET PEERS?

A good example is in the area of technology. In Asia, the abbreviation 'R&D' used to refer to 'Replication and Duplication'. However, times have changed. Today, Asian companies are at the cutting-edge of research and development into new technology. This is focused on five key growth areas: i) smartphones, ii) augmented and virtual reality, iii) the smart-home, iv) artificial intelligence; and v) electric and autonomous vehicles. Three examples are outlined below:

- **Smartphones:** In recent years, Chinese smartphone manufacturers have consistently gained global market share from the two leading incumbents, Apple and Samsung Electronics. Companies such as Huawei, Vivo and Oppo, which were relatively unknown outside Asia a few years ago, now have a combined global market share outpacing both Apple and Samsung.
- **Artificial Intelligence:** Companies in the region are investing heavily to spearhead research into Artificial Intelligence. Baidu, for example, China's largest internet search company, is focusing on Artificial Intelligence, including voice recognition, voice synthesis and facial recognition, with the aim of further improving its core internet search business.
- **Electrical vehicles:** In the future, we believe that usage of electric and autonomous vehicles will be far more widespread. Global investors often select developed market companies to play this theme. However, we believe there are more compelling opportunities in Asian companies that make crucial components, such as electric vehicle batteries, wire harnesses, gear boxes, charging stations and cameras for autonomous vehicles.

2 WHAT ARE THE BENEFITS OF FOLLOWING AN ACTIVE APPROACH TO EMERGING MARKET EQUITIES?

We believe that fundamental, bottom-up research provides the best opportunity for long-term growth. In many emerging economies, company governance structures are not as mature relative to more developed markets. Furthermore, in this area of the market, information gaps can lead to a mispricing of securities. To exploit these gaps and uncover the right investment opportunities, active, bottom-up analysis is required. An active approach is also required to access a broader universe of opportunities because only 10% of Emerging Market stocks are captured in the MSCI Emerging Markets Index. In short, we believe that active management is essential in unlocking the true value in Emerging Market equities.

3 EMERGING MARKET EQUITIES HAVE PERFORMED STRONGLY LAST YEAR – IS THERE STILL ROOM FOR THEM TO GROW?

Yes. Aside from the continued acceleration in economic growth of Emerging Markets versus the developed world, we believe there are three reasons they will continue to perform:

- **Diminishing political risk premium:** Historically, one of the biggest arguments against investing in Emerging Markets has been that political risk was much higher than in the developed world. Today, political risk in the developed world has edged higher since the election of President Trump, the Brexit referendum in the UK and the uncertainty surrounding the efficacy of the EU model. We believe, therefore, that political risk is arguably no longer a legitimate reason to avoid investing in Emerging Markets.
- **Consensus underweight:** By most measures, investors continue to be underweight Global Emerging Market (GEM) and Asia ex Japan equities. GEM represents around 12% of the MSCI All Countries World index. However, global equity funds currently have around 8-9% of their exposure in GEM. As a result, Emerging Markets is an uncrowded asset class, with the potential to rally further if investors continue to reduce their underweight positions. Flows into this sector of the market are also far from their peak level in 2013, so we believe there is continued scope for demand.
- **Attractive valuations:** Global Emerging Market equities continue to trade at a 20-30% discount to global and US equities, combined with higher expected EPS growth rates.