# THE OUTLOOK FOR EMERGING EQUITY MARKETS

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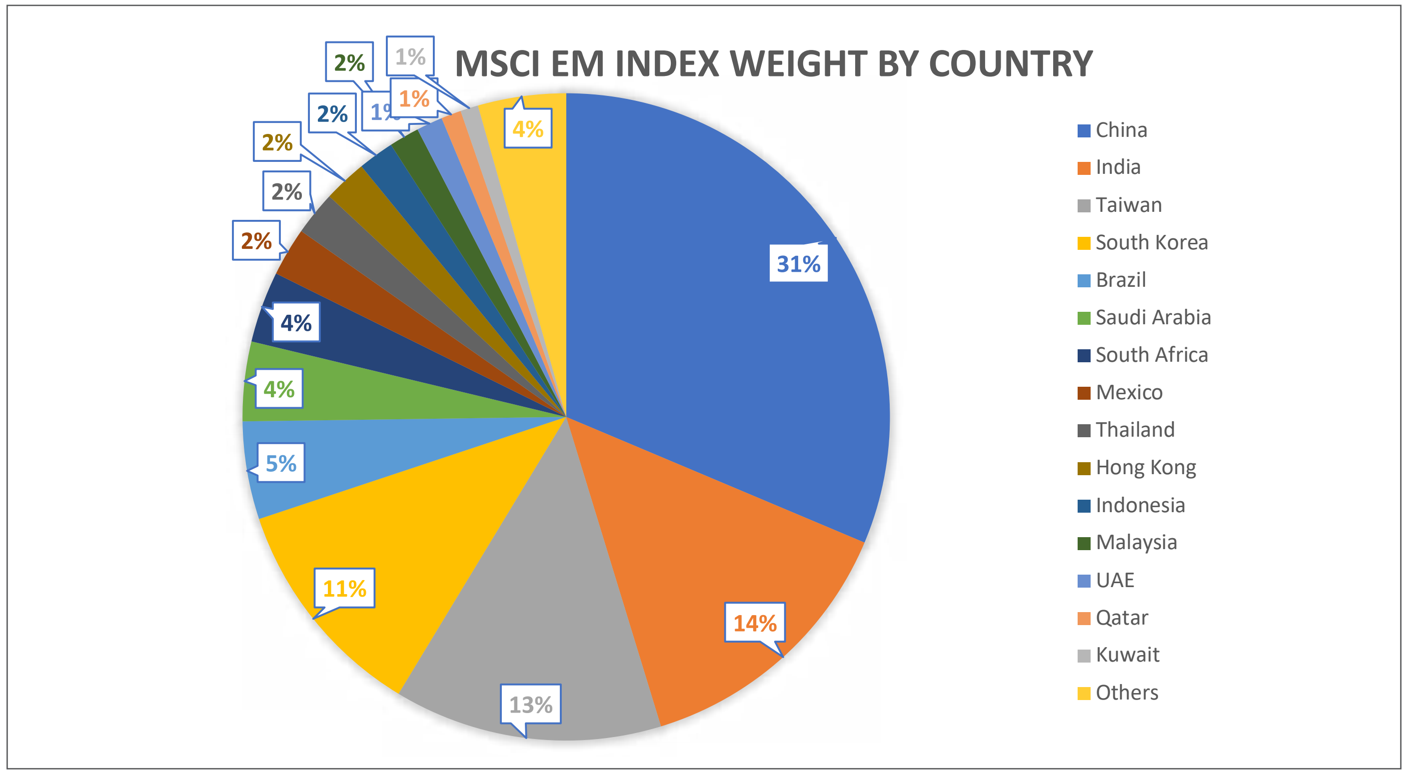
## Introduction:

The MSCI Emerging Market (EM) Index is composed of large and mid-cap companies across 24 Emerging Market (EM) countries, with nearly 1,377 constituents.

The top 10 countries by weight represents 89% of the Index weight. EM equities account for close to 12% of global large and mid-cap market capitalization.




*Source: MSCI*

## Discussion:

EM represents many of the fastest growing markets globally. Over the past three years, EM equities have underperformed Developed Markets (DM). However, by late 2023, what have been macro headwinds for EM equities could reverse to tailwinds, with the overall outlook becoming more positive. Inflation is expected to fall globally, with recent corrections in oil, gas and food prices, while supply-chains issues have improved overall. Crucially, we believe the US dollar will weaken. Also, with China's economy eventually reopening after the worst of Covid has been dealt with, EM economic activity could pick up. A standout within EM economies is India, and this is explored in a separate article within the GIO. We believe EM equities could perform well in 2023, although country selection will be crucial. We regard the jury as still being out on China.

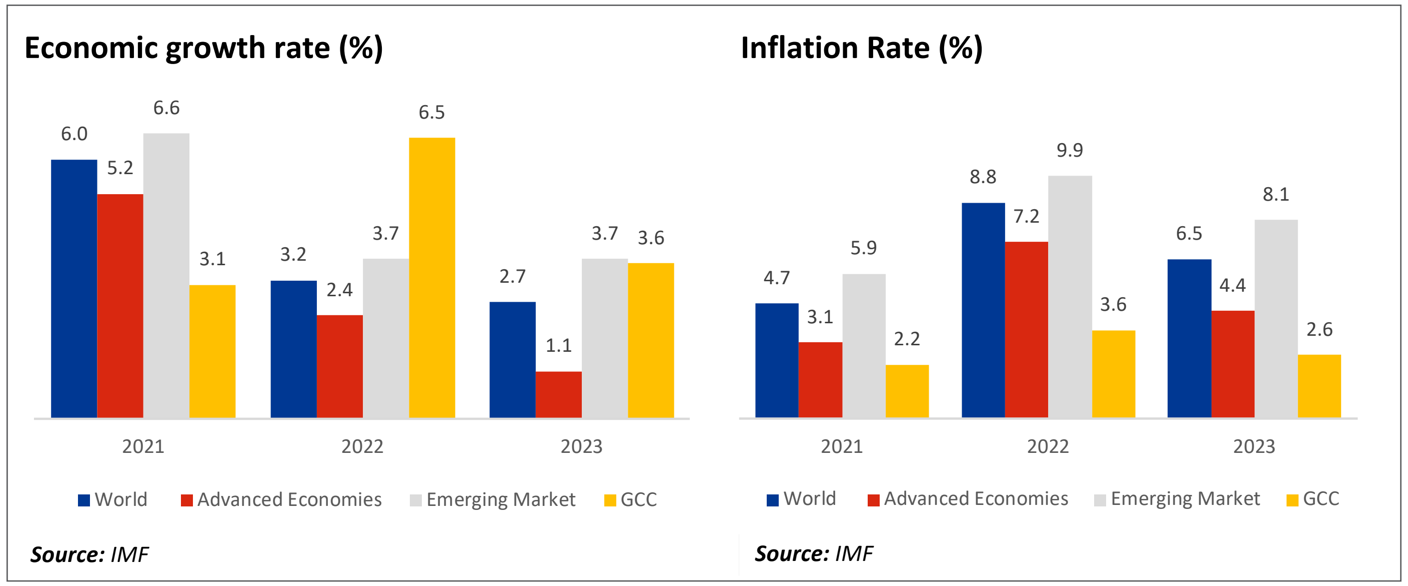


We suggest elsewhere in this GIO that although the Fed's rhetoric should pivot, the Fed funds rate itself could remain high as a safeguard against future economic exuberance. Even so, the Fed funds futures curve could fall, at least to some extent. This could lead to the weakening of the dollar index, and also the possibility that some EM currencies also rally against the US dollar.

## EM's real economic growth rate is expected to outpace that of the DMs

Economic growth is likely to be much stronger in EMs than in developed economies during 2022-26, according to the International Monetary Fund (IMF).

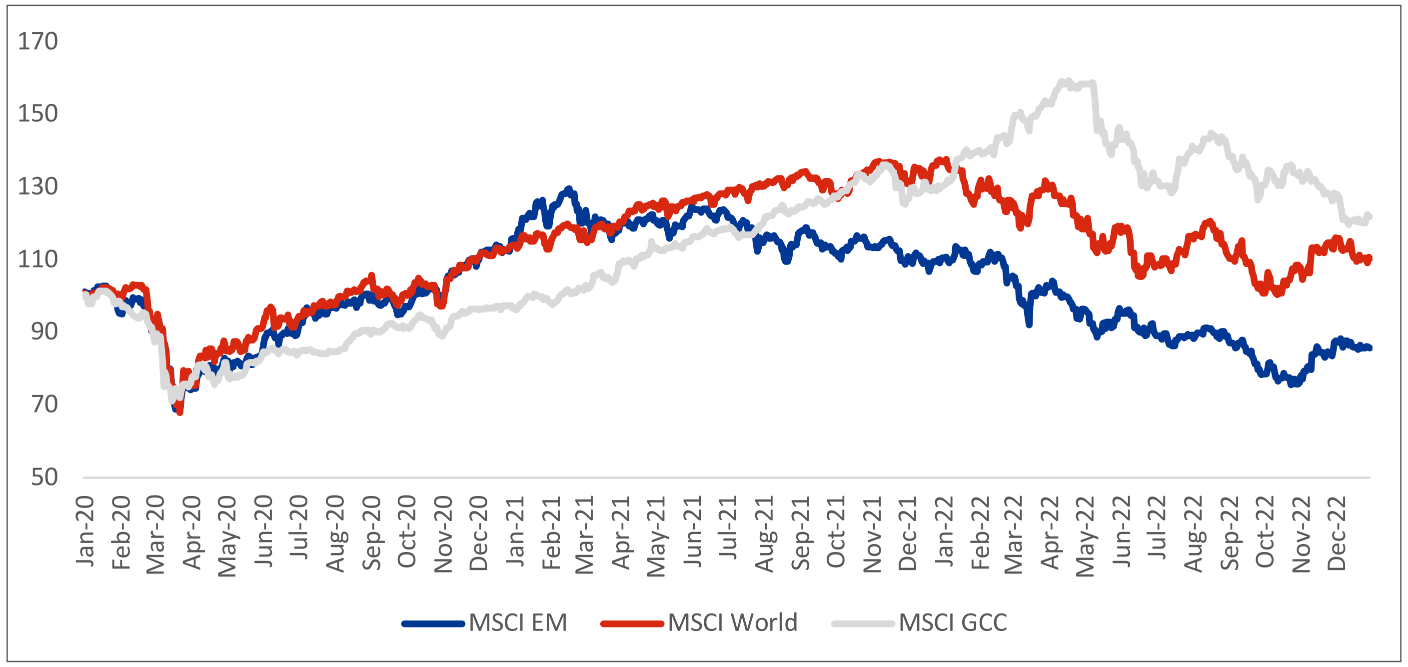
Real growth in developed economies is expected to decelerate in 2023, while in EM it is expected to remain unchanged, at 3.7%. In the immediate months to follow, though, recent Chinese data suggests the IMF (and other forecasters) will likely reduce its China GDP growth forecast of 4.4% for 2023. Developed economies are expected to deliver low GDP growth, of 1.1% this year (IMF), with a possible recession in many developed countries. The economic growth in EM is primarily due to high growth in emerging and developing Asia and Europe, partially offset by slower growth in Latin America, the Middle East, and Central Asia. Inflation in emerging markets is forecast by the IMF to decline from 9.9% in 2022, to 8.1% in 2023.



## EM has underperformed DM for the last two years

Global equities enjoyed strong returns from late March, 2020, until the end of 2021, with DM outperforming EM, which continued into 2022. In that year EM equities fell 22.4%, worse than the DM loss of 19.5%. The underperformance was partially due to the conflict in Ukraine conflict, which pushed up oil prices and derailed the global food supply, leading to higher inflation globally, but which all mitigated more against EM than DM countries. Added to this, as the major central banks resorted to aggressive rate hikes to control inflation, which hurt EM more than DM countries.

### MSCI Index's Historical trend

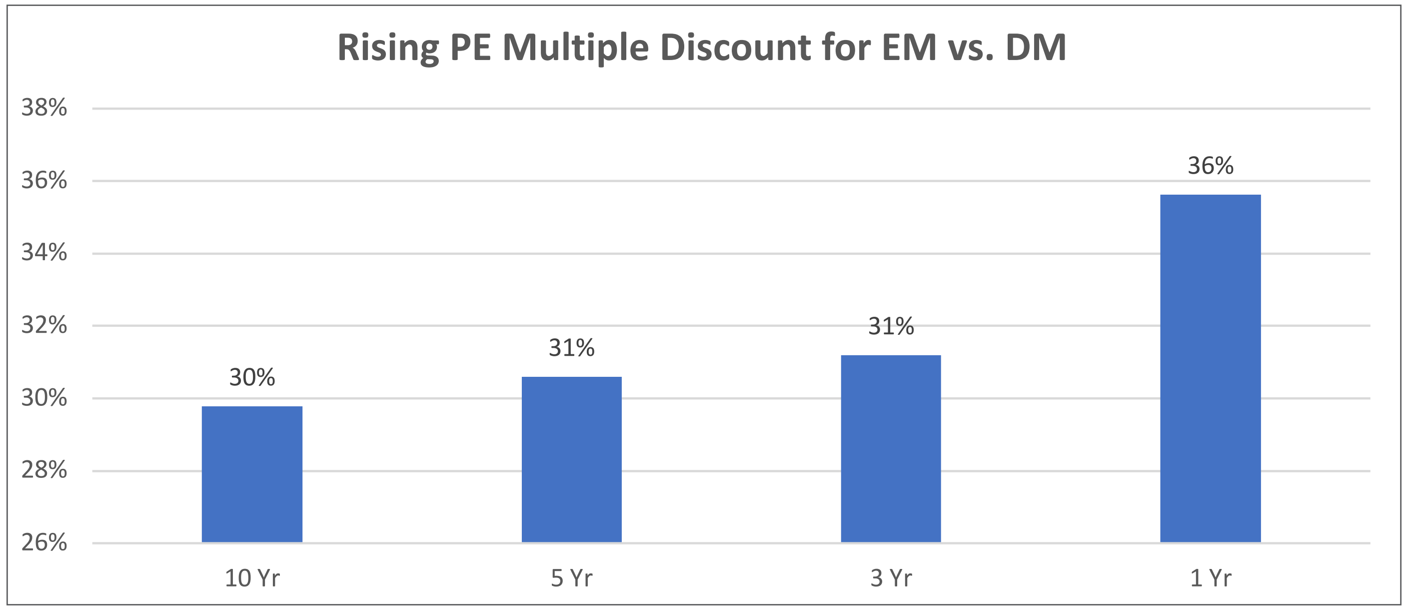



*Source: Bloomberg, All Index Values rebased to 100 in January 2020*



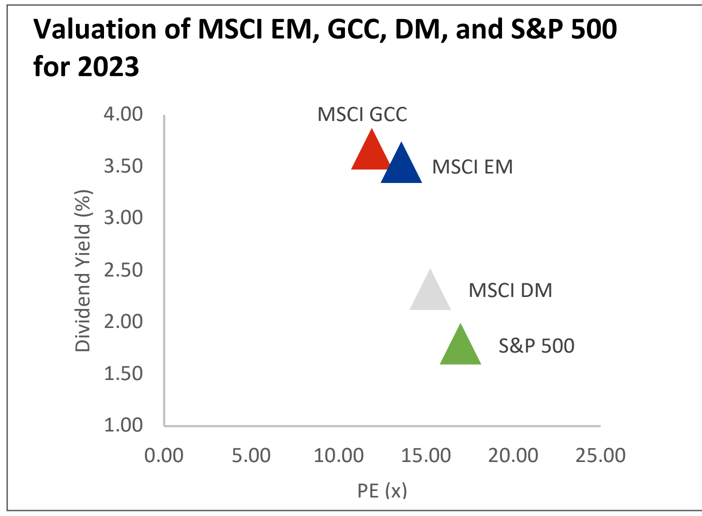
## EM benefits from attractive valuations and a rebound in profitability

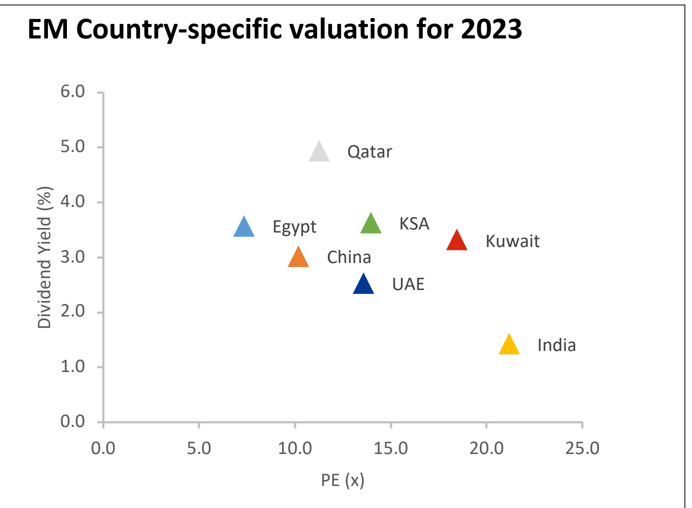
Emerging markets as a class were also hurt in 2022 by China's regulatory crackdown, the strong dollar, and the large rise in US bond yields. Historically, the MSCI EM Index has always traded at a discount to the MSCI World Index (which is DM only); over the past 10 years the average 12-month forward PE multiple for EM has been at a discount to DM of around 30%. During the last year, however, the discount has further increased to 36%.




*Source: Bloomberg*

On a relative basis, the valuation for EM is on the face of it more attractive compared to DM, however seasoned investors know that corporate governance, political risk, currency volatility, and so on are likely to be a continuing influence. Even so, a forward P/E discount as high as it currently is probably does represent a good relative value investment opportunity. Sound country selection is of course crucial.




*Source: Bloomberg*

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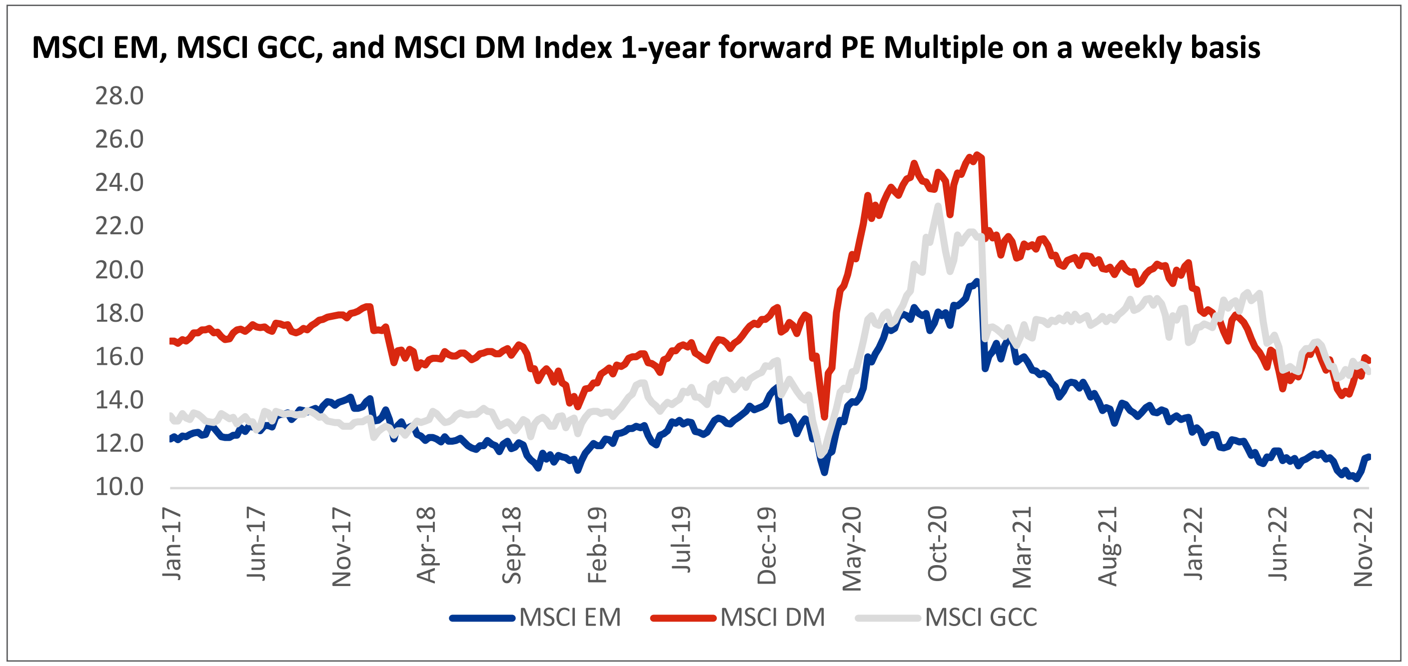
***Notes:*** *UAE Index: Abu Dhabi Stock exchange (ADX); India: Nifty50 (NIFTY)*
*China: Shanghai Stock Exchange Composite Index (SHCOMP)*
*Kuwait: Boursa Kuwait Premier Market Price Return Index (KWSEPM)*




## Current Valuation Based on Expectations for 2022

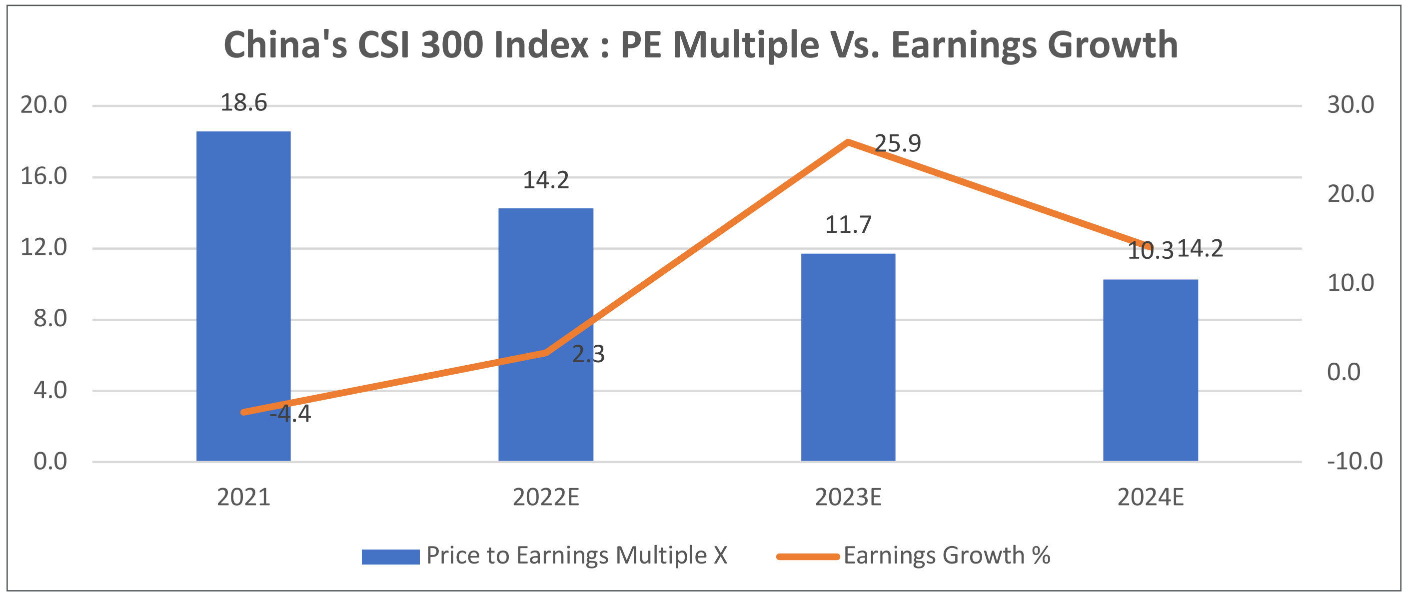
| | PE (x) | PB (x) | Dividend Yield (%) | ROE (%) |
|---|---|---|---|---|
| MSCI EM | 11.4 | 1.4 | 3.4 | 11.7 |
| MSCI DM | 15.2 | 2.5 | 2.3 | 15.2 |
| MSCI GCC | 14.2 | 2.0 | 3.5 | 23.8 |

*Source: Bloomberg*



## Chinese economy should eventually benefit from reopening, after Covid is dealt with

Once Covid is dealt with in China (possibly through herd immunity), its economy should be able to recover, although probably to nowhere near the average of the previous 25 years. China's current economic slowdown is clearly a headwind to global trade and growth, and at a time when higher interest rates are adversely impacting growth in the name of bringing inflation under control. China's CSI 300 Index is trading at a 2023 PE multiple of 11.7x, a discount to its five year 12-month forward average of 15.4x.




*Source: Bloomberg*

Global investors have during the last few years stayed away from Chinese equities due to concerns related to its property sector, as well as continuing worry that government policies towards the important technology sector (and others) could be more supportive than they have been. Any decline in the dollar index will provide support to EM currencies and equities and boost their valuations. Any signs of an improvement in US-China relations would naturally help Chinese equity valuations, with potential benefit to the whole asset class. We would not go as far as to say that Chinese equities are uninvestable; rather, we are sitting on the sidelines for the time being until some of the factors mentioned above turn around. Indian equities are discussed at length in Abhishek Shukla's article on the subject, and that sub-class is by far our favourite for the medium and long term.