GLOBAL EMERGING MARKETS

MARTIN CURRIE

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For institutional, professional and wholesale investors only

EMERGING MARKETS: EVOLUTION OF THE ASSET CLASS

The full breadth of emerging markets 'ex-China' is underestimated and diverse. China remains an exciting place to invest, but as it grows, the emergence of an emerging markets ex-China asset class continues to take shape. In this piece we shine a light on some of the key areas of structural change which are helping to evolve the asset class and discuss how emerging market companies, especially those outside of China, are placed to benefit from them.

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Looking beyond China for investment ideas

China is now a very large part of the MSCI Emerging Markets Index (roughly a third) and gives investors access to several exciting structural change themes, with companies there increasingly being acknowledged as global leaders. Less well understood perhaps are the opportunities offered by the rest of emerging markets outside of China. There are many exciting opportunities to be found when you delve more deeply into the other 23 countries which constitute the MSCI Emerging Market Index; they are underestimated and diverse.

The case for an ex-China portfolio

As the Chinese market has grown, interest in unlocking the opportunities outside of China more directly has risen. Much like Asia ex-Japan, China's continued growth may lead to a similar emergence of Emerging Markets ex-China as an asset class in its own right. We have already observed investors looking to manage their China exposure independently of their broader exposure to emerging markets and we believe this trend could continue.

In May 2022, Martin Currie launched a Global Emerging Markets ex-China strategy in recognition of the fast-paced innovation and structural changes within emerging markets as a whole. An ex-China portfolio provides investors with the ability to allocate a higher active weight to the many opportunities outside of China. Importantly, while we have high conviction in the long-term opportunities offered by Chinese equities, we also recognise that some investors may desire the choice and flexibility to manage their emerging markets exposure ex-China.

There are, of course implications for your portfolio when excluding China. By constructing our portfolios to be stock-driven, we are well-placed to run an ex-China portfolio alongside our core emerging markets portfolio. Being country and beta neutral enables the ex-China portfolio to reflect the same risk and style characteristics as our core portfolio, with a tilt toward quality growth. The removal of Chinese companies from the index also improves its average MSCI ESG rating, both on a simple and weighted average basis[1].

[1]Source: MSCI, March 2022.

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The performance of Chinese companies has been a strong contributor to asset class performance, particularly in recent years. A closer analysis of individual country components over the long term reveals that there have been several countries with similar strength, such as Brazil, Colombia, Indonesia and India. The Middle East has also shown strong performance as a region in the more recent 10- and 15-year periods. Emerging markets are more than China alone.

Total return of MSCI Emerging Market constituent countries

Total return by country	10 years	15 years	20 years	30 years	Since inception	Inception date
Brazil	(17)	19	490	1,304	6,216	Dec-1987
Chile	(43)	(4)	249	347	3,827	Dec-1987
China	47	89	583		36	Dec-1992
Colombia	(44)	59	1,622		1,392	Dec-1992
Czech Republic	63	56	1,220		1,268	Dec-1994
Egypt	(21)	(35)	828		939	Dec-1994
Greece	(71)	(97)	(88)	(81)	(46)	Dec-1987
Hungary	38	(25)	249		882	Dec-1994
India	138	137	1,096		1,172	Dec-1992
Indonesia	28	177	1,300	422	2,143	Dec-1987
Korea	51	84	402	694	814	Dec-1987
Kuwait	134	67			154	May-2005
Malaysia	(13)	33	188	234	630	Dec-1987
Mexico	3	23	314	601	10,303	Dec-1987
Peru	8	108	1,350		2,951	Dec-1992
Philippines	33	129	491	218	798	Dec-1987
Poland	(24)	(50)	111		798	Dec-1992
Qatar	88	247			159	May-2005
Saudi Arabia	234	341			86	Aug-2014
South Africa	14	46	481		1,039	Dec-1992
Taiwan	240	303	462	602	1,330	Dec-1987
Thailand	28	200	863	250	975	Dec-1987
Turkey	(47)	(44)	123	396	551	Dec-1987
United Arab Emirates	278	98			39	May-2005

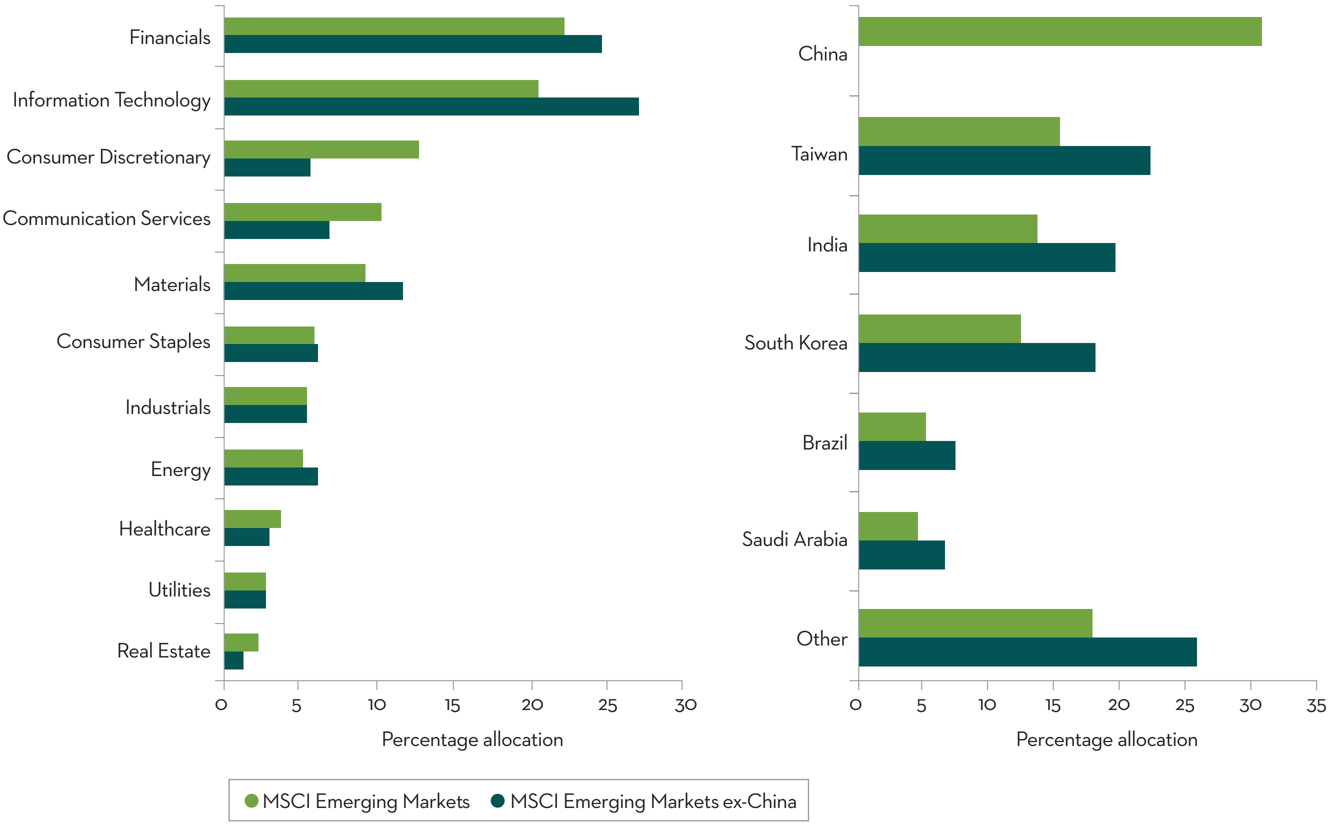
Source: Morningstar. Total USD return of MSCI country indices which form the MSCI Emerging Markets Index. Data to 30 April 2022 using monthly compounding.

The implications for country allocations in an ex-China portfolio are fairly intuitive, with Taiwan, India and South Korea becoming the dominant component countries. The impact on sector allocation is more nuanced.

Taking the MSCI indices as a proxy for the market as a whole, we observe that the main impact of removing China from your investment universe is an increase in allocation to IT stocks and the decrease in consumer discretionary stocks. The rebalancing between other sectors is less pronounced.

China's removal reduces the pool of consumer discretionary companies, but it does not mean that industry-leading companies in this sector cannot be found outside of this region, as we will demonstrate in the upcoming sections. Similarly, several best-in-class global technology companies are located outside of China, leading to the larger allocation to this sector in an ex-China portfolio.

Change in sector and country allocations for an emerging market portfolio without China



Source: MSCI as at 30 April 2022.

The emerging markets opportunity is broad and deep, benefitting from structural change across different areas. In the coming pages we outline these changes and highlight some examples of ex-China companies who are poised to benefit from them.

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Structural change is driving the emerging market opportunity

Ex-China markets are benefitting from some of the important changes we have identified[2] as reshaping the investment landscape across the asset class, falling into the broad opportunity sets of **Sustainable Planet**, **Demographics** and **Technology**.

Sustainable planet

Demographics

Technology

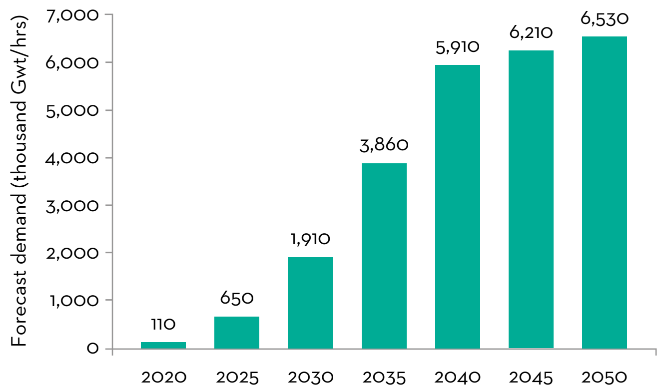
Roughly three quarters of our Global Emerging Markets portfolio stocks are exposed to these opportunity sets with many companies having exposure to more than one. Importantly, many of these companies also offer varying levels of support to the UN Sustainable Development Goals (SDGs). In the following pages we discuss why these opportunities exist, provide examples of key themes to which we are exposed and how portfolio companies are capitalising on them.

Sustainable planet

According to the International Energy Agency (IEA), meeting the accelerated decarbonisation goals associated with achieving global net zero carbon emissions by 2050 would require a step up in annual energy investment from US$1.5 trillion per annum historically to US$5 trillion per annum by 2030.[3] This spend will be directed to clean energy and we are already seeing this impact the investment opportunity set in emerging markets. From battery technology to renewable power generation and power management systems, we see a diverse range of opportunities for investment.

In particular, the theme of electrification will be key in the years to come. Electrifying our power needs has a huge role to play in the next phase of decarbonisation and the pathway towards net zero. We have already seen this in the prominence of emerging market companies in the electric vehicle (EV) supply chain but we remain at the early stages of a long-term transition and they still have much more to offer. Emerging market companies will continue to play a leading role in bringing the technologies and the equipment to the global market that will allow us to pursue a more electrified world. Emerging markets are also expected to be significant consumers of these products.

Forecast electric vehicle battery demand worldwide 2020-2050



Source: Statista and The Faraday Institution. Faraday Insights – Issue 6 Update: June 2020, page 2.

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2https://www.martincurrie.com/insights/The-best-of-both-worlds-Why-now-for-Emerging-Markets

3IEA World Energy Outlook 2021, page 113.

Sustainable planet (cont.)

Within the broader opportunity set of **Sustainable Planet**, we have identified three key opportunity areas of Resource Efficiency, Electric Vehicles and Infrastructure.

Resource efficiency

Electric vehicles

Infrastructure

Roughly 35 of our core strategy's portfolio holdings have some exposure to at least one of these opportunities. 25 of these are beyond China, spanning industries such as communications, energy storage, e-commerce and EVs. Key areas of opportunity include the rise of EVs and electrification.

Electric vehicles

The staggering expected increase in EV battery demand over the coming decades highlights the depth of the opportunity for EVs more broadly. Beyond the batteries themselves, the opportunity also extends to different parts of the value chain, such as charging stations, copper and auto parts.

Beneficiaries of this trend include **Delta Electronics** (Taiwan), which, within its business lines of power electronics, industrial automation, components and energy management, has significant exposure to clean technologies. This includes EVs through charging stations. Chilean copper miner **Antofagasta** is expected to benefit not only from the increase in EV demand, where copper is a key component, but also more broadly from the theme of electrification of our energy needs and the global trend toward decarbonisation. Copper demand is estimated to increase by 50% in the next 20 years[4] and the increased consumption of electronics, the proliferation of electric vehicles and the increased use of renewable energy sources will all be supportive of demand. EV batteries are a significant area of opportunity and the portfolio has roughly 9% exposure to these producers.[5] Key holdings exposed to this theme are South Korean companies **LG Energy Solution** and **Samsung SDI**. Both companies are expected to continue to benefit from the multi-decade eco-friendly vehicle revolution, with growing order backlogs and impressive technology.

The products and services produced by the companies we highlight above help to support the following SDGs:

[4]Source: McKinsey, 'The future is now: How to win the resource revolution', https://www.mckinsey.com/business-functions/sustainability/our-insights/the-future-is-now-how-to-win-the-resource-revolution

[5]Representative Global Emerging Markets account as at 26 January 2022.

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Demographics

The demographic changes over the last decade present investment opportunities across themes of Live Longer, Live Healthier, Financial Inclusion, Urbanisation and Vanity and Leisure.

Live Longer, Live Healthier | Financial Inclusion | Urbanisation | Vanity & Leisure

Roughly 37 of our portfolio holdings have some exposure to at least one of these demographic opportunities. 26 of these are beyond China.

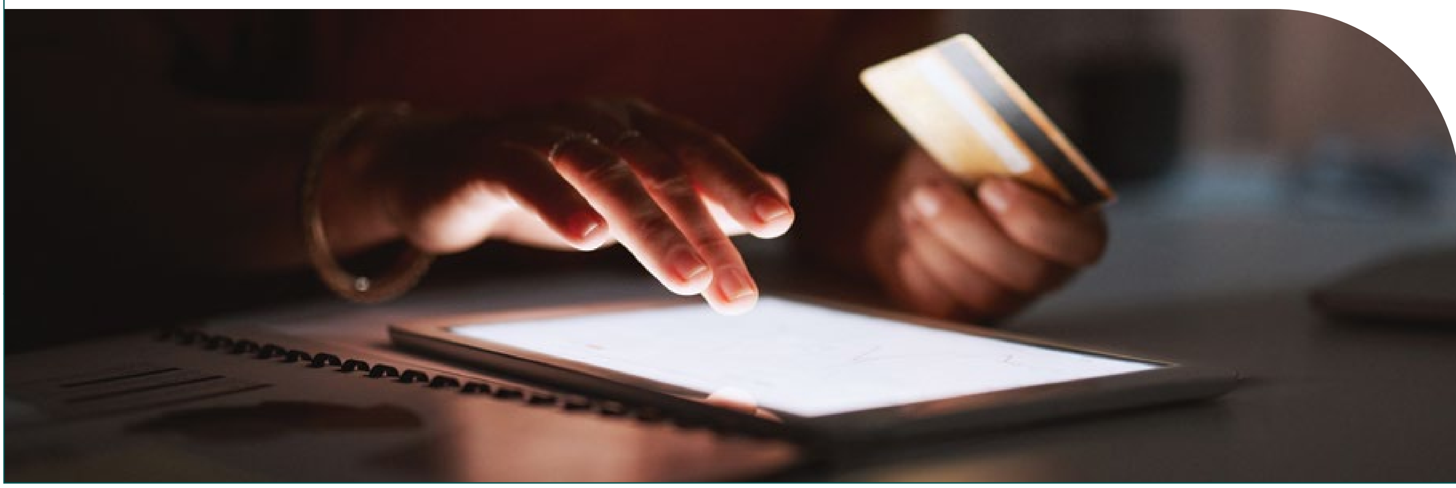
Growing affluence, particularly in Southeast Asia has helped support strong consumption. Combined with structural reforms, this has helped the development and growth of domestic emerging market companies and many digital companies with a global footprint. A new breed of consumer has been created which embraces digital solutions, from e-commerce, gaming and entertainment to payment apps and digital banking. We are at the early stages of a long-term trend and should expect increasing innovation as companies try to gain a competitive edge.

Within emerging markets, an exciting area exposed to demographic trends is e-commerce/online business.

e-commerce and online businesses

The demographic changes experienced in emerging markets have helped to nurture this trend, allowing companies like **SEA Ltd** to flourish. The global consumer company demonstrates gaming and e-commerce leadership across the key countries in emerging markets, particularly Taiwan and Southeast Asia. Beyond its gaming business, which boasts some of the world's most downloaded games, SEA's understanding of the consumer and ability to localise its offering has allowed it to establish its brand Shopee as an e-commerce leader across several major markets. Its payment service further helps to smooth transactions and enable financial inclusion. Aside from the longevity of opportunity in its existing business, its track record of execution provides tangible optionality for further geographic expansion and development of other product categories including food delivery or other digital financial services. We are very excited to see how SEA grows and adapts in order to capture the broader macro opportunities in Southeast Asia over the years to come.

SEA Ltd's products and services help to support the following SDGs:



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Technology

Alongside broader economic growth, recent years have seen emerging market companies move up the curve in terms of complexity, human capital and intellectual property (IP). Many of these companies are leading the way in a global marketplace and are considered best-in-class, without true developed market peers. This is especially true in relation to technology.

The combination of a highly educated workforce, youthful populations readily embracing digital transformation, and adaptive and innovative management teams has resulted in emerging market companies which truly have no global peers. Key areas of opportunity which we have identified as a result are Cloud and Data Revolution, Digital Disruption, AI and Automation and IP Leadership.

Cloud and Data Revolution

Digital Disruption

AI and Automation

IP Leadership

36 companies in our portfolio have exposure to at least one of these technology-related opportunities. Of these, 25 are outside of China. In particular, the semiconductor industry is a key beneficiary of this broad opportunity. As a result, roughly 20% of our portfolio is exposed to this industry.[6] Other areas of opportunity are broad as sector lines blur due to the embrace of technology across different sectors, from financial companies and platform businesses to more unexpected sectors such as healthcare.

Semiconductors

Semiconductor manufacturers benefit directly from the rise of digitalisation in society provided they invest in their businesses sufficiently to capitalise on that opportunity. Huge leaps in digital have taken place in recent years such as the smartphone, smartwatch, cloud/data services, tablets and robotics. Semiconductor firms such as **TSMC** (Taiwan), **SK Hynix** (Korea) and **Samsung Electronics** (Korea) have exposure to all these technologically innovative areas and will continue to do so as new products are developed, both in emerging markets and the rest of the world. As enablers of technology, they have limited or low risk of product obsolescence. We are excited to see how they help to support rapid digital innovation across many areas such as computing, communications, consumer electronics, automotive and industrial equipment.

The products and services provided by the companies we highlight above help to support the following SDGs:

[6]Representative Global Emerging Markets account as at 26 January 2022.

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The exciting road ahead

As interest in emerging markets ex-China as an investible asset class continues to develop, Martin Currie is well positioned to take investors on the journey, should it prove a reality. We are excited to highlight some of the many opportunities available outside of China. The global move towards sustainability, changing emerging market demographics and rapid technological change have created a wealth of investment opportunity. Many emerging market companies are investing in their businesses in order to embrace these trends. This is evident within domestic markets as well as the broader global supply chain, as the examples we have discussed demonstrate. These provide a small insight into the depth of the opportunity within emerging markets outside of China. The diversification offered by the many markets in the asset class cover a huge breadth of sectors and themes, with the added benefit of helping to support several Sustainable Development Goals.

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