OUR VIEW OF EMERGING MARKETS IN 2024

OUTLOOK

Most Emerging Market economies were relatively robust in 2023 with Q3 GDP growth in major countries such as India of 7.6%, 4.9% in Indonesia, and 3.1% in Brazil (rolling four quarters). In terms of smaller markets, the latest PMI readings of 57.5 in Saudi Arabia and 56.8 in the UAE also demonstrate significant optimism, as does Thai consumer confidence reaching the highest level since February 2020.

Furthermore, interest rates have already started to fall, with **200bp of cuts in Brazil since July 2023**, 100bp of cuts in Poland since July, and 150bp of cuts in Vietnam since February.

However, this unabashed good news has been **masked by the global headwinds** of sticky inflation and persistent rate rises in the US and Europe.

These issues dissipated as we moved into the latter part of 2023, with the December US Fed meeting acting as the **key pivot** point. Interest rate declines are now being discussed for 2024, with uncertainty relating purely to magnitude and timing.

We believe that declining US interest rates, and the consequently weaker US Dollar, combined with the existing and already evident economic strength in many Emerging Markets should result in an extremely positive backdrop for the asset class.

As **the asset class has significantly underperformed over the last five years**, rising just 19.8% in US Dollar terms versus 82.7% for the 'World' index* over that period, **Emerging Markets benefit from both strong growth and attractive valuations** as we move into 2024.

FOUR PREFERRED MARKETS FOR 2024

India remains the best multi-year structural growth story, confirmed by recent macro-economic data and Modi's electoral success at the state level in December. We expect to see continued economic strength, boosted by interest rate cuts in 2024, and Modi's undoubted success in the upcoming national elections. Although valuations are always a challenge, we remain **able to find attractively valued companies** given the breadth of the market and our **extensive experience in unearthing undiscovered Indian companies over almost 30 years.**

Saudi Arabia's reforms are still under-appreciated and the market is **still under-owned by investors**, who perhaps only view the country through the prism of the oil price. We believe that this a lazy and false narrative. Crown Prince Mohammed bin Salman is determined to rebalance the economy, for example by encouraging tourism, which we believe will be successful. In addition, the average population age is only 29.2 years (compared to 28.2 years in India or 44.4 years in the EU), resulting in an increasingly dynamic consumer market.

**Source: Bloomberg, as of 29 December 2023.*

Thailand's economy is heavily dependent on international tourism, accounting for approximately 12% of pre-covid GDP. However, this has been slow to recover. The recent formation of a new government led by Srettha Thavisin from the Pheu Thai party, has resulted in political stability and a desire to kick start the economy. **Tourist arrivals are now finally re-accelerating** (with a 53% increase over the last three months, year on year), which we believe will act as a long-awaited catalyst.

Brazil will continue to benefit from substantial interest rate cuts throughout 2024, which combined with **ongoing structural reforms** (for example, of the horrendously complicated tax structure) should result in an acceleration of economic growth. These tax changes were cited by S&P as one reason for their December upgrade of Brazil's long term credit rating to BB.

In addition, we believe that there are **also exciting opportunities in the smaller, and often overlooked**, markets of **Greece, Poland, UAE and Vietnam**. We are currently invested in 20 markets, which is a consistent source of differentiation versus peers and ETFs.

At a sector level, we believe that the outlook for **Technology Hardware** (predominantly in **Korea** and **Taiwan**) is exciting due to the confluence of three factors; the bottoming of the semiconductor cycle, new AI-driven applications, and the upcoming consumer electronics upgrade cycle. We are also particularly positive in 2024 on the beneficiaries of our theme of **Digitalisation** (notable in **Brazil, Singapore and China** – but also in **Saudi Arabia, Poland and Korea**), given the strong structural growth drivers of the sector combined with a declining interest rate environment.

WHAT ABOUT CHINA?

Winston Churchill defined Russia in 1939 as a 'riddle, wrapped in a mystery, inside an enigma', but perhaps this is now a more apt description of China. The economy is recovering (industrial production increased from 4.6% year on year in November to 6.6%, and retail sales growth increased from 7.6% to 10.1% over the same period), but the pace is slow and patchy. Valuations are extremely attractive. But the politically driven nature of the economy is ever more apparent under President Xi, and geo-political risk remains present.

We do not expect any reversal of the gradual improving trends – both economically and (geo)politically - in the coming months ahead of the US presidential election, nor do we anticipate any intensification of the tension with Taiwan above the current levels of rhetoric. However, we are increasingly concerned that China may be considered a value trap, given the non-fundamental drivers of the stock market and the rising importance of state-controlled companies in terms of market performance (which we do not invest in).

Hence, our overall weighting to China will be **strictly risk-controlled**, and our focus will be on compelling bottom-up **opportunities in fundamentally driven, private-sector companies**. We expect the ongoing and increasing negative sentiment towards China to provide an increasing number of **cheap and overlooked opportunities**.

AN UPCOMING YEAR OF ELECTIONS

2024 consists of a multitude of elections in Emerging Markets, as well as those in the UK, EU and US. These are our key thoughts:

India. Modi is expected to convincingly win a third term as Prime Minister, given his wide popularity and ineffective opposition, as demonstrated in recent state-level elections.

US. Could a Trump victory result in renewed anti-China rhetoric ? It is certainly possible, however in contrast India was unaffected in his previous term and this is again likely, given the structural, domestic nature of India's rise.

South Africa. How badly does the ANC perform, and how influential do the far-left EFF party become?

Indonesia. Jokowi cannot run again, however his policies are likely to persist under a new President. But, the leisurely nature of the electoral process (elections in February, with the Presidential swearing in ceremony only in late-October) could dampen market sentiment.

Mexico. Ruling party candidate, and Mexico City mayor, Claudia Sheinbaum is on course to replace President Obrador. Major policy changes seem unlikely.

2023 RECAP

Despite outperforming our peers in both 2021 and 2022, the Alquity Future World Fund did not keep pace in 2023. **This was almost entirely due to our poor returns from China** and Chinese linked companies (for example in Korea).

With hindsight, China's economic recovery was slower and patchier than we had expected and thus the size of our position and our pro-growth focus were both detrimental.

Furthermore, the **underperformance of well-run, private-sector companies** compared to state-linked companies also was a significant negative contributor to our disappointing returns. As just one example, in the financial sector, the share price of our key holding declined 20% during the year despite an improving outlook and earnings, whereas the large state controlled banks delivered positive returns, some of which were substantial. We believe that these entities are managed in the interests of the Chinese government rather than minority shareholders, and thus we do not consider them appropriate investments for clients. We recognise that there are periods of time when low quality companies outperform high quality companies, but typically the duration is limited.

Elsewhere, **our stock selection was positive or neutral in almost all regions (ex. China)** with notable contributions from:

- Egypt
- Saudi Arabia
- India
- Indonesia
- Taiwan

In almost every one of the above examples, **the main stock contributions were from out-of-index companies**, as our **differentiated investment approach** delivered strong returns.

In terms of key asset allocation performance drivers, the Fund suffered from the overweight in Thailand, but benefited from our positioning in the Middle East and Greece.

IMPACT

Although data collection remains an issue and a focus, we are now able to increasingly review companies versus their peers across EM sectors and **identify different sustainability practices and methodologies**. This enables us to subsequently engage on outliers (as well as with ESG data providers), and **has added a further layer to our approach to engagement** during 2023. For example, we recently engaged with Bank Mandiri, given a higher GHG intensity compared to other EM banking peers (due to limited solar power and a significant reliance on coal in Indonesia's power mix).

In total, **we engaged with 87 of our owned companies** during 2023. Topics were both company specific and thematic. For example, engaging with all our holdings where the auditor tenure exceeded five years, and advocating for shorter auditor terms to bolster transparency, independence, and accountability. In terms of our sector analysis, for example, we engaged with all our auto-related holdings on their processes to prevent child labour usage, given Hyundai's issues in Alabama in this regard.

Furthermore, we undertook our second group engagement which focused on the governance of Mediatek in Taiwan, as well as **joining several collaborative efforts** - such as the investor coalition for a Global Plastics Treaty, the investor coalition on addressing deforestation in Indonesia's nickel supply chain and several FAIRR initiatives, such as seafood traceability and the use of antibiotics in the QSR industry.

In addition, **58% of the companies that we owned throughout the year recorded an improvement in the Key Progress Indicators that we track**, with 42% remaining stable and 0% backsliding. This is one of the strongest outcomes that we have recorded, helped by increasing disclosure requirements in India.

CONCLUSION

Emerging Markets have fallen out of favour with many investors over recent years. However, given the strong underlying fundamental investment case for many Emerging countries combined with attractive valuations and – finally – a supportive global backdrop, we expect 2024 to herald a much-deserved change in fortunes for the asset class.

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