Emerging markets equities

Emerging markets can extend their winning ways in 2018

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Key takeaways

- Favourable prospects for emerging markets are built on strong foundations.
- We expect Asian technology companies to continue to perform well in the coming year.
- Driven by valuations, the EMEA region may provide fertile ground for stock-picking opportunities.

Drawing support from an improvement in fundamentals at both a macro and corporate level, emerging equity markets significantly outperformed their peers in the developed world in 2017.[1] Going forward, we expect this positive environment – favourable economic prospects, a pickup in global trade activity, sluggish inflation and competitive currencies – to provide an attractive landscape in which companies could prosper. With a supportive global macro backdrop, we are confident that companies can build on the generally stronger performances witnessed in 2017 and continue to deliver on the earnings front in 2018.

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Emerging Asia

The Chinese economy – much like the rest of emerging Asia – is expected to remain resilient, underpinned by strong domestic consumption, an export recovery and solid growth in services. However, we believe that economic growth in China may moderate in 2018 as the government pushes to rein in debt and further extend anti-pollution measures. In South Korea, increased global demand for tech products is likely to support an economy that remains in good shape despite a rise in geopolitical tension with its northern neighbour. Exports from Taiwan are also picking up steam, aided by demand for components for the coming iPhone X and other tech-related products.

Latin America

We believe the economic recovery in Latin America is gaining traction and broadening. Recent macro data releases from Brazil have been encouraging, reaffirming the growing view that the economy is finally on the mend. The Brazilian economy, in our view, is also likely to benefit from lower interest rates and waning inflationary pressures. In the near term, economic activity in Mexico might be held back by the earthquakes, but nonetheless, we believe the economy remains in good shape and should continue to grow at a steady pace in 2018. The political environment in the region is also becoming more supportive, with pro-market governments implementing business-friendly reforms.

Emerging Europe

We are seeing further evidence that a nascent economic recovery remains in place in Russia. Prudent policymaking and a strengthening rouble are providing a more stable backdrop for companies to invest. Lower interest rates are helping to reawaken consumer demand, with the revival in real pay accelerating in recent months. The macroeconomic picture in central and eastern Europe is also improving, with hard data in the region surpassing expectations. With growth picking up in the eurozone, we believe the region's prospects are improving.

Sector favourites

With many emerging market economies heading in the right direction, there has been an improvement in the earnings growth outlook. As usual, however, there still remains a wide dispersion between countries and sectors. Looking ahead we expect technology companies to continue to do well along with banks and some consumer discretionary firms. While we envisage earnings growth to increase at a faster pace in Asia (for example, Korean and Chinese tech firms), we are confident that companies in Brazil, South Africa and Russia will also deliver. We favour Asian tech-hardware companies and Chinese internet businesses. The former tend to generate significant free cash flow, and the latter, in our view, continue to have strong growth prospects.

In conclusion

As active stock pickers with a long-term investment horizon, the use of valuation metrics plays an important role in our stock selection process. Although 2017 has been a good year for emerging equity markets, they still trade at a significant discount to developed markets and towards the bottom end of their long-term range (on a price-to-book basis). With companies in good health and well-positioned to deliver on the earnings front in 2018, we believe there still remains

1 Source: FactSet Research Systems. Developed markets, represented by the MSCI World Index, returned 18.21% from Jan. 1, 2017, through Oct. 31, 2017. Emerging markets, represented by the MSCI Emerging Markets Index, returned 32.26% over the same time period. Past performance is not a guarantee of future results.

fertile ground for stock-picking opportunities. Driven by valuations, we expect that some of the most attractive opportunities may be located in the EMEA (Europe, Middle East and Africa) region, particularly Russia, Greece, Turkey, Poland, the United Arab Emirates and South Africa. That's where we will be following our judgment and putting more resources to work.

> Favourable economic prospects, a pickup in global trade activity, sluggish inflation and competitive currencies combine to provide an attractive landscape in which companies could prosper.

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