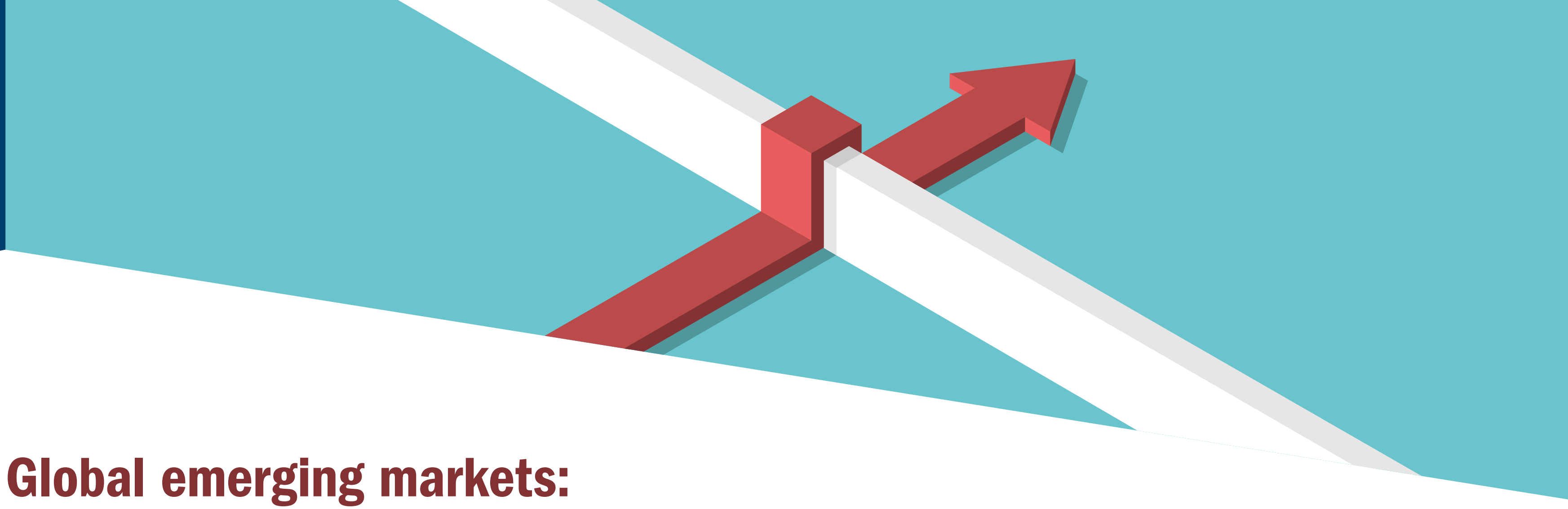

Global emerging markets: gaining momentum

Dara White, Global Head of Emerging Market Equities

- Despite its huge impact, the Covid-19 pandemic has done little to disrupt the powerful structural trends driving growth in emerging markets. We expect these trends to gain additional momentum in the coming year.
- With a supportive macro-economic environment and the promise of vaccines becoming widely available in 2021, we believe the key long-term trend driving EMs will assert itself more strongly than ever.
- We see significant opportunities across consumer discretionary, information technology and communication services sectors, where there is exciting global growth potential as businesses develop products and services to meet evolving consumer tastes.
- We are finding a growing number of companies that meet our "quality growth" investment style with strong, investor-friendly management teams and the ability to fund their growth internally while increasing their returns on invested capital.

Despite its huge impact on health and wellbeing, the Covid-19 pandemic has done little to disrupt the powerful structural trends driving growth in emerging markets (EMs). We expect these trends to gain additional momentum in the coming year and for EMs to remain unchallenged as the primary engine of global economic growth.

As we enter 2021, the macro-economic backdrop is extremely supportive. Several major economies, notably China and South Korea, were among the first to be hit by the pandemic, but thanks to their robust approach to tackling its spread they have recovered strongly and are well positioned to continue their rebound. More generally, EMs are benefiting from the global wave of interest rate cuts and liquidity injections. Moreover, they have more scope than developed markets to apply further stimulus, thanks to their higher real interest rates.

With a supportive macro-economic environment and the promise of Covid-19 vaccines becoming widely available during 2021, we believe the key long-term trend driving EMs – their transition from export-led growth to reliance on buoyant domestic demand – will assert itself more strongly than ever.

Nowhere is this clearer than in the shift we have witnessed in the centre of gravity of the global middle classes. In October, the Washington-based Brookings Institution pointed out that China is experiencing the fastest expansion of the middle class the world has ever seen,[1] adding that this was taking place "during a period when the global middle class is already expanding at a historically unprecedented rate thanks in part to some of its neighbours like India". The Brookings paper forecasts that the Chinese middle class will reach 1.2 billion people by 2027, representing a quarter of the global total. By comparison, in the 1950s more than 90% of the world's middle classes lived in Europe and North America.

This continuing shift will fuel strong domestic demand for goods and services, a significant proportion of which will be met by fast-growing domestic companies. We believe themes such as digital innovation, ecommerce and digital payments penetration, financial deepening and environmental development – all of which have been reinforced by the effects of the pandemic – will provide rich sources of investment opportunity through the coming year and beyond.

> *With a supportive macro-economic environment and the promise of Covid-19 vaccines, we believe EM's transition from export-led growth to reliance on buoyant domestic demand will assert itself more strongly than ever*

Our approach to capturing these opportunities will lead us to continue to focus on the EM companies serving domestic demand. We see significant opportunities across consumer discretionary, information technology and communication services sectors, where there is exciting global growth potential as businesses develop products and services to meet evolving consumer tastes.

[1] https://www.brookings.edu/wp-content/uploads/2020/10/FP_20201012_china_middle_class_kharas_dooley.pdf October 2020

Healthcare is another sector that has accelerated during the pandemic. With healthcare spending in China only around 5% of GDP, compared to 17% in the US,[2] there is a clear trend of where this sector could go. In China people are getting older, richer and sicker. Big bang reforms have been a key catalyst for the industry, with its membership of the International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use (ICH)[3] helping to integrate China's clinical process and adherence to global standards. As such, drug approval and reimbursement times have since fallen dramatically.[4] The market has opened up and there is now the demand and capability to realise it. We wouldn't be surprised if the healthcare sector doubles in weight over the next few years.

> ***Many investors remain under-allocated to EMs, but the case for owning this asset class is becoming stronger – a growing number of companies meet our "quality growth" investment style***

Elsewhere, there are pockets of growth in financials thanks to digital innovation. For example, in Brazil record-low interest rates[5] are driving investment in equities and creating opportunities. As financial deregulation, structural reform and technology adoption continue, we expect areas such as digital brokerage and payments to yield more prospects for high growth. And although the pandemic has slowed the reform agenda in EMs somewhat, the long-term trend is intact. Indeed, we note that important reforms are progressing in countries including Brazil, Indonesia, India and China.

Many investors remain under-allocated to EMs, but the case for owning this asset class is becoming stronger. We are finding a growing number of companies that meet our "quality growth" investment style with strong, investor-friendly management teams and the ability to fund their growth internally while increasing their returns on invested capital.

We see the growth and diversification benefits of this asset class as compelling, and believe 2021 will offer attractive opportunities to increase exposure.

[2] https://data.worldbank.org/indicator/SH.XPD.CHEX.GD.ZS December 2020.
[3] https://www.biopharminternational.com/view/china-joins-ich-global-harmonization-efforts August 2017.
[4] FT.com, Global drugmakers strike deal to slash prices in China, 28 November 2019.
[5] https://www.bloomberg.com/news/articles/2020-10-28/brazil-holds-key-rate-at-2-as-growth-woes-outweigh-fiscal-fears October 2020.

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