EMERGING MARKETS:

AN EVOLVING LANDSCAPE

MARTIN CURRIE

A Franklin Templeton Company

AUGUST 2024

For institutional investors in the US only

MAPPING THE EMERGING MARKETS JOURNEY

INVESTING TO IMPROVE LIVES™

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From hope to hesitation

Over the past decade, emerging markets (EM) have experienced mixed fortunes, as strong early performance was followed by more recent lacklustre returns[1]. The strong US market and dollar as well as the weak Chinese economy impacted returns. The next decade may see EM stock markets return to their former glory.

In this series, we will put into context the recent difficult period and explore the key reasons why we believe one should continue allocating to EM equities.

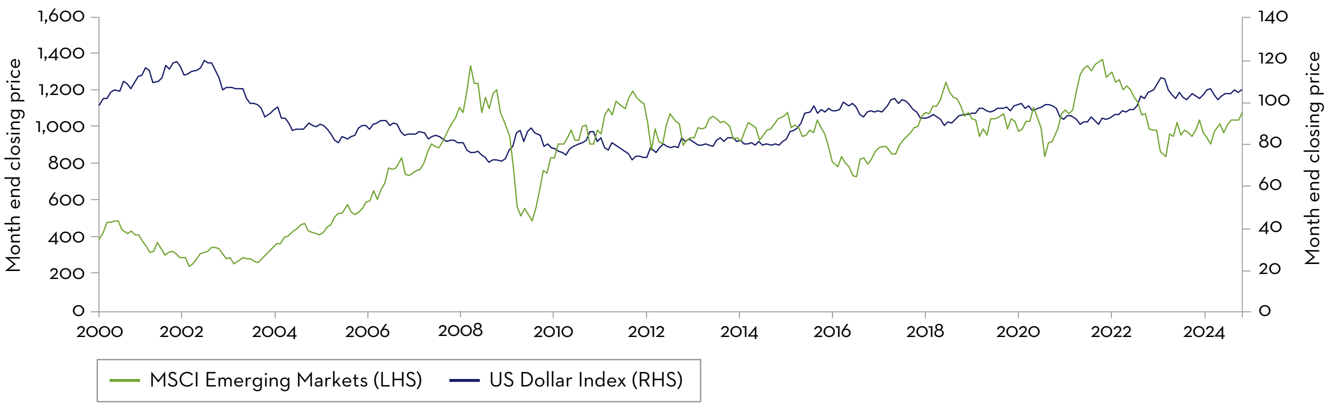
Recent challenges

FROM THE US

There are two key areas which have challenged EM performance from 2010 – 2023:

1. It has been a one-way bet in the US. The US dollar strength has led to the strong outperformance of US stocks over EM across the last 13 years. Over the medium and long-term, US stocks have had significantly higher correlation with the US dollar than EM stocks do.[2]
2. Although in the past there have been times when EM has overcome dollar strength, since the beginning of 2021, the strong dollar has been a significant headwind for EM performance.

Inverse correlation between EM performance and the US dollar over 23 years



Source Bloomberg and FactSet. Data shown from 1 January 2000 to 30 June 2024.

As we are approaching the end of the interest rate cycle in 2024 and with indications of rate cuts in the near future, there are some important implications for EM.

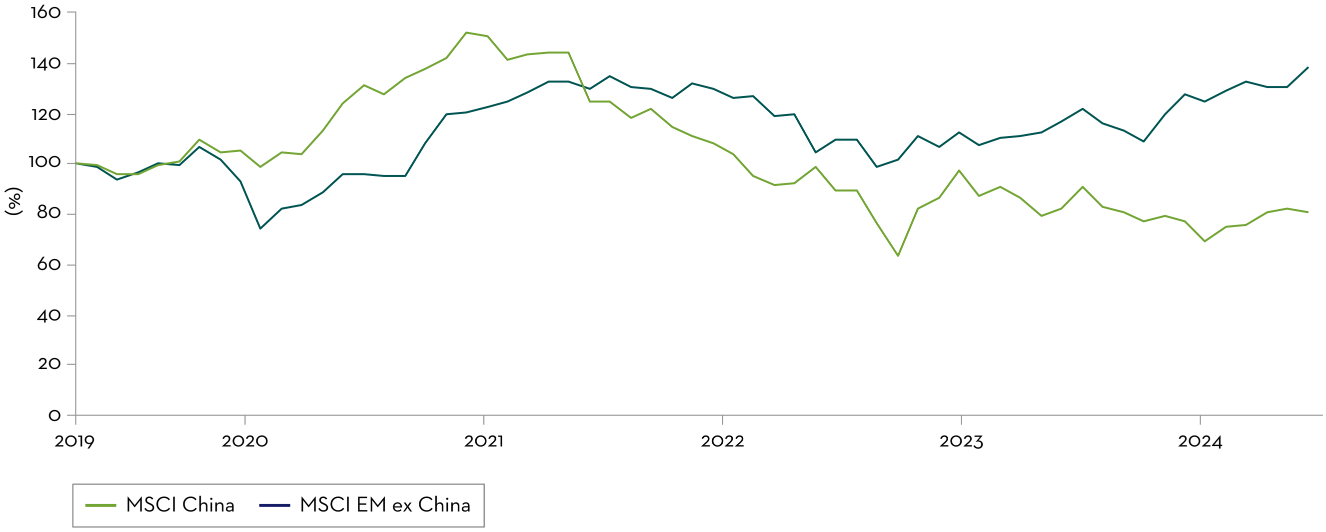
[1]Source: Morningstar: MSCI EM NR USD, MSCI EAFE NR USD, MSCI USA NR USD: 31 December 2000 – 31 December 2023.

[2]Source: FactSet as at April 2024.

FROM CHINA

The second significant challenge for EM investors has been the recent material underperformance of China, which represents a quarter of the asset class and is a significant driver of its returns.[3]

China's underperformance has impacted EM returns over last five years



Source: MSCI, returns show in US dollars for 30 June 2019 to 30 June 2024.

The recent underperformance of China has dragged down asset class returns.

There are three key worries about China:

- **Economic slowdown –** driven by weakness in the real estate market
- **Geopolitical tensions –** particularly the relationship with the US
- **Policy –** the direction of domestic policy with regards to the private sector, Covid, and economic stimulus

Hesitation on these three factors has meant that China has seen a material valuation derating in the past few years. We think China presents a counter consensus valuation opportunity.

[3]China represents 25.1% of the MSCI Emerging Markets Index. Source: MSCI, 30 April 2024.

AN EVOLVING LANDSCAPE

It is important to remember that the EM market is not the same as ten years ago, or even the decade before that. Since the significant outperformance of the early 2000s[4], the shape of the asset class has changed. Information technology is the largest sector allocation in the asset class and commodities no longer dominate[5]. Consumer-focused industries, represented by consumer discretionary stocks also represent a meaningful component of the index as we have seen tremendous growth in per-capita incomes in all of the major EM economies. Finally, we have seen the impact of the digital era as billions of consumers have been able to access new consumption opportunities within e-commerce, gaming, and digital finance.

Despite the headwinds facing EM recently, in our view, the landscape is now positively shifting and this **Emerging Markets: An Evolving Landscape** series will explore the key drivers with the potential to dictate the future of the asset class:

US:
Policy backdrop becoming more favourable

CHINA:
Returning to a fundamental-driven market should close the valuation gap

INDIA:
The potential of an increasing ability to drive forward earnings growth

TECHNOLOGY:
Increasingly being valued for its global leadership

Past performance is not a guide to future returns. There is no assurance that any projection or forecast will be realised.

[4]Source: Morningstar: MSCI EM NR USD, MSCI EAFE NR USD, MSCI USA NR USD: 31 December 2000 – 31 December 2023.

[5]Source: Factset as at 21 May 2024.

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