GLOBAL EMERGING MARKETS

2025 Outlook

MARTIN CURRIE
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What lies ahead?

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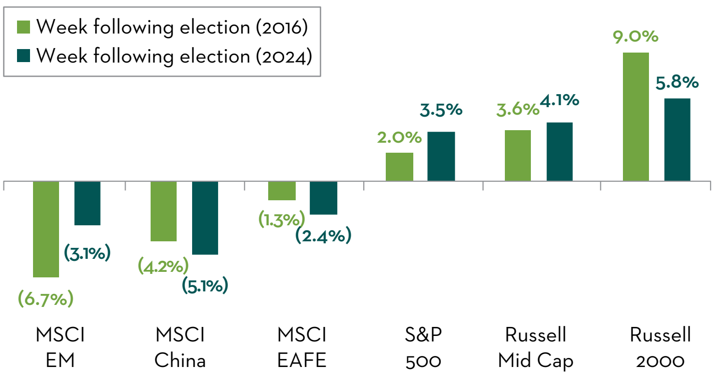
Reflections on 2024

The past year has been a positive one for global equities. US markets continued their leadership, while emerging markets outpaced developed international markets.

For most of the year, EM was among the best performing asset classes – driven positively by information technology (IT) stocks and China, which rallied following coordinated stimulus announcements. However, in the fourth quarter, EM faced headwinds coinciding with the election of Donald Trump as the next US president. Investors braced for import tariffs, US tax cuts, and other policies that are expected to favour domestic-oriented US companies. As a result, bond yields rose, the US dollar strengthened, US small-cap stocks rallied, and non-US equities declined.

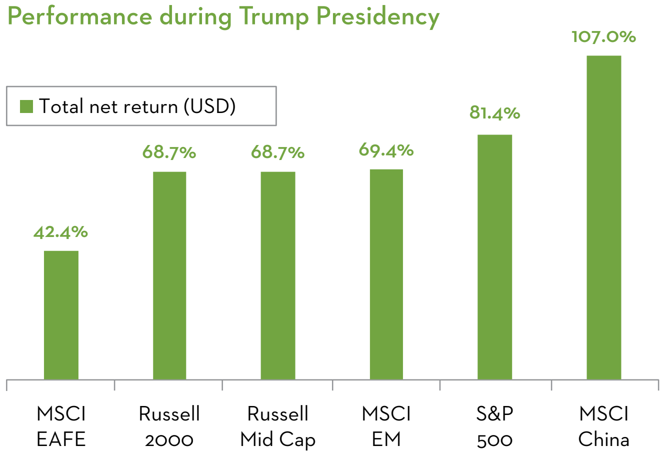
The market's initial reaction appears strikingly similar to the period following Trump's 2016 win (see chart below). It's important to note though that many of these trends reversed course during Trump's first term – bond yields fell, the US dollar weakened, and US large-cap bested small-cap. Importantly, EM performed strongly, and China outperformed the US with a total return of over 100% during that time (versus the S&P's return of 81%).

Performance of global equities following US election (2016 and 2024)



Source: Morningstar as at 9 December 2024. Market returns for Donald Trump's presidency: 20 January 2017 to 19 January 2021.

Performance during Trump Presidency



Source: Morningstar as at 22 November 2024.

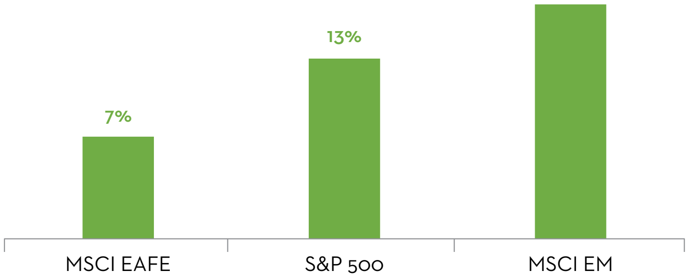
While we acknowledge that the political conditions and economic cycle are different this term, we also do not expect the market's recent pessimism to persist. In fact, we believe that EM is well positioned to benefit in both the near and long term, as we discuss in this piece. As we look to 2025 and beyond, we believe long-term, structural opportunities persist in EM especially within China, India, and the IT sector.

We are optimistic about 2025

There are many reasons to be positive about EM. These are the three key points of optimism:

1. Strong earnings growth expectations: Earnings growth expectations are superior to developed markets, including the US.
2. Investor allocation upside: The cautious sentiment is reflected instead in global allocations to EM being at 10-year lows.[1] Simply a return to the 10-year average allocation would see inflows of USD 1.6trn into EM.[2]
3. Return to fundamentals: We believe markets will refocus on company fundamentals and that the key building blocks for growth are those operating in the IT sector, India and China.

Three-year Earnings Growth



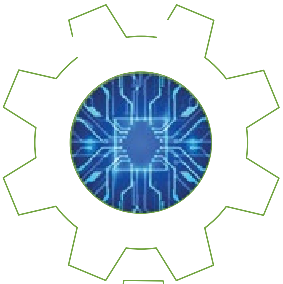
Source: FactSet as at 16 December 2024. Earnings per Share (EPS) Growth measured using the Compound Annual Growth Rate (CAGR) from 1 January 2024 to 31 December 2026.

[1]Source: JPMorgan, EM Money Trail as at 11 October 2024.

[2]Source: Statista and BCG as at August 2023. Based on 2022 Global AUM of USD 98.3trn.

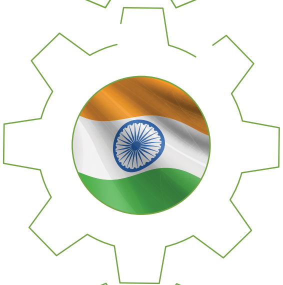
Optimism Beyond 2025

As long-term investors, we look beyond the short-term noise. In 2025 and beyond, we expect markets refocus on company fundamentals, the key building blocks for growth are those operating in the IT sector, India and China.



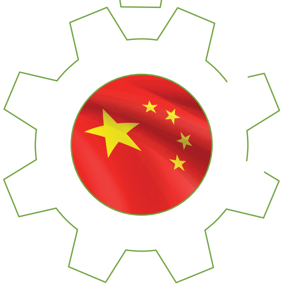
Information Technology: 23% of MSCI EM

EM companies are at the heart of artificial intelligence (AI) innovation. The sector has grown in size to represent almost a quarter of the asset class and is a beneficiary of long-term structural growth.



India: 20% of MSCI EM

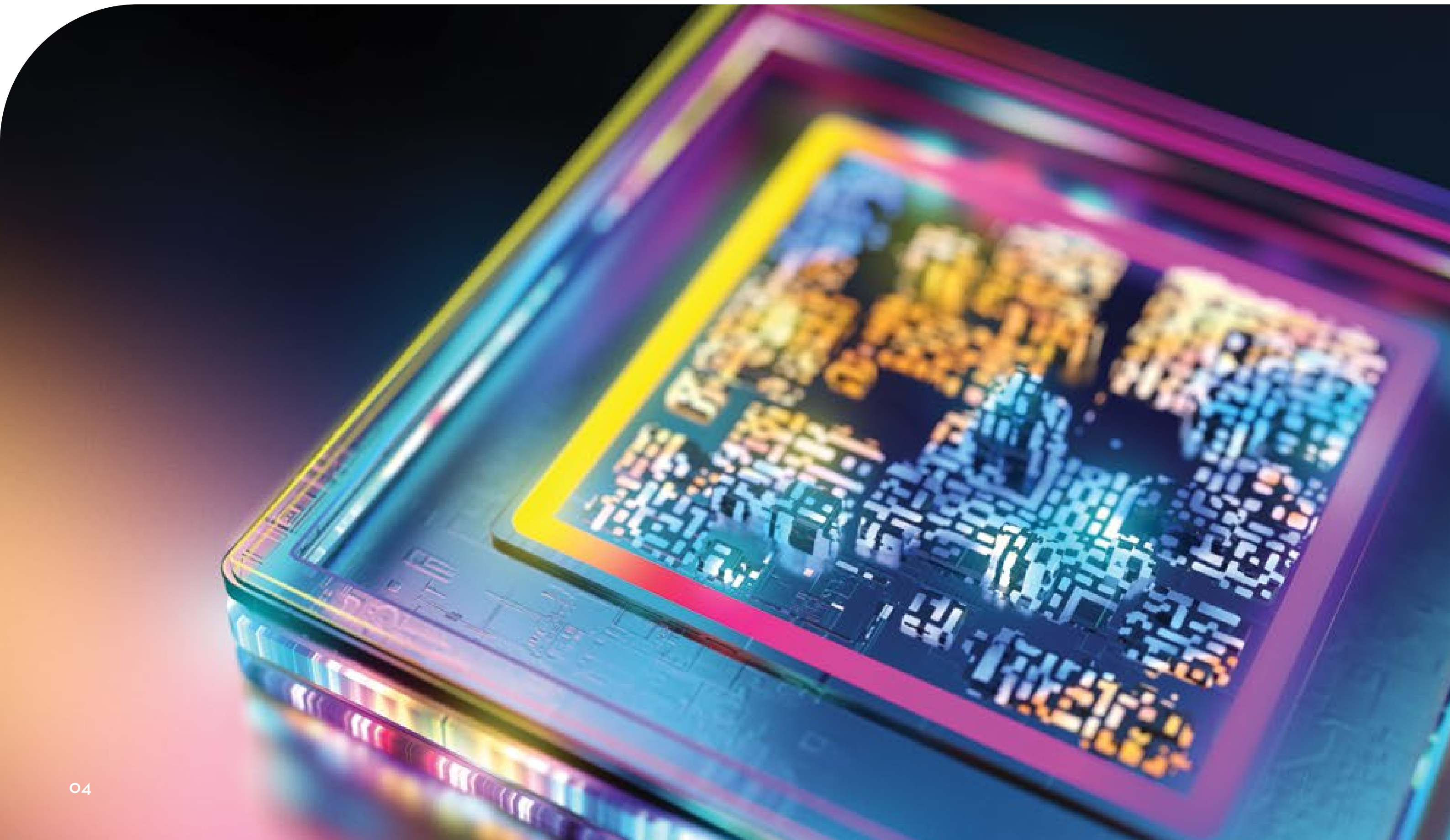
India has the potential to drive returns in EM over the next decade as structural growth opportunities come to fruition and companies rise to the challenges presented to them. We see a significant opportunity in the near-term for high quality growth companies to be rewarded for strong fundamentals.



China: 27% of MSCI EM

In 2024, Chinese equity market performance began to recover as market participants started to recognise company fundamentals. Chinese companies have been delivering operationally with strong earnings growth. We believe there is a long runway for further growth and we look forward to seeing this materialise in 2025.

Source: FactSet, index weightings as at 27 November 2024.

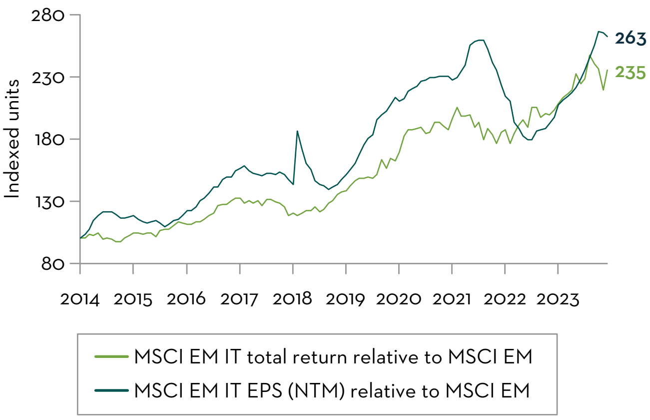


Information Technology: EM integral to AI innovation

Strong fundamentals can drive success in EM IT

EM technology has been a core driver of EM returns during the past decade, driven by earnings delivery. Consensus estimates suggest that this trend will continue – EM IT offers almost double the growth of US technology in the next three years. The sector's significantly lower relative valuation also offers an attractive entry point and suggests that the growth runway is significant.

EM IT returns and earnings over 10 years



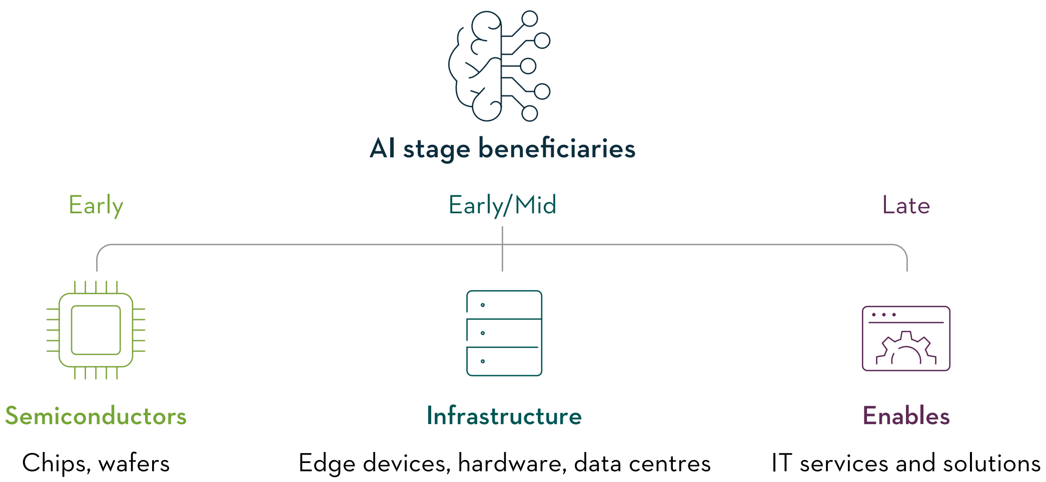
Source: FactSet. EPS using Next Twelve Months (NTM) Earnings.
Past 10 years: 28 November 2014 to 31 October 2024.

MSCI Index	P/E (NTM)	Three year EPS Growth (%)
EM Technology	15x	37%
US Technology	28x	19%

Source: FactSet as of 27 November 2024. P/E using NTM Earnings and the EPS Growth measured using the CAGR from 1 January 2024 to 31 December 2026 for the MSCI Emerging Market Technology Index and MSCI USA Technology Index.

EM has depth and breadth of exposure to the AI value chain

The life cycle of AI adaption creates opportunities over varying time horizons: early, mid and late stages of AI development. Geographic diversification remains crucial across EM to capture the range of opportunity. Our positioning in IT brings several elements that are unique and differentiated. First, we are diversified across the life cycle of AI adaption. We have companies that are set to benefit from all age stages of AI development. Second, we have diversification across geographies with companies in Korea, Taiwan, India, Central and Eastern Europe, and Latin America. Finally, we have companies that are positioned for global growth but also uniquely positioned for dramatic upside; our cohort of technology investments have reasonable valuations compared to developed market peers.



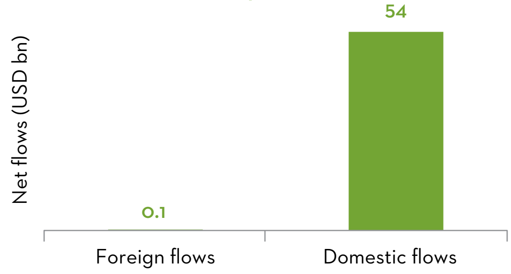
We are excited about the near- and long-term opportunities for emerging market technology companies. Given the increased adoption of AI, EM technology is well-placed to benefit.

India: a return to fundamentals

Foreign investment due to catch up with domestic

India's stock market performance was largely driven by domestic participation and not necessarily by earnings delivery this year. In fact, domestic investor flows climbed to over USD 50bn while foreign flows were flat – almost double the previous year's domestic flows. This short-term trend has a distorting market impact, and has supported industrials, infrastructure and power companies, especially mid-caps, in 2024. This has also been supported by unsecured loan growth to the domestic retail market who have invested their loans in these areas. Much of the growth has been driven by inflows to domestic mutual funds – the majority of which have been funded through individuals' Systematic Investment Plans. These invest a set amount each month into the market and their usage has increased, as well as the amounts being invested. Essentially it means that those areas of the market already held in domestic mutual funds have seen flows, driving up prices.

Net flows to Indian equities



Source: CLSA Research, India Strategy: Flowmeter, October 2024. Year-to-date flows from 1 January 2024 to 31 October 2024.

While the unsecured loan growth and the domestic investor flow increase are two distinct trends, they are interlinked. The Indian government has already begun to crack down on this increase in unsecured lending and as it is brought under control, we expect to see a compression in the valuation premium between Nifty Midcap and Nifty as evidenced historically.

Quality large caps offer a valuation opportunity

While mid-cap equities have been supported by domestic investment, this has pushed them to an outsized premium valuation compared to large caps. The mid-cap index has much larger allocation to industrial companies and real estate, while the large cap index has greater representation from financials and IT companies.[3] We see opportunities in large-cap companies across a diverse range of sectors including Financials, IT and Consumer sectors that should benefit from structural tailwinds.

We therefore expect this retail phenomenon to be short-lived; high quality companies with sustainable growth are well placed to outperform in the long term.

Index	P/E (NTM) 26 June 2022	P/E (NTM) 8 November 2024
Nifty	19x	22x
Nifty Midcap	20x	38x

Source: Bloomberg, as at 8 November 2024.

Recent equity performance in India has been driven by domestic retail investors, pushing mid-cap names higher. Long-term compounding companies have not seen the same price appreciation despite delivering operationally. We think the market is due an adjustment in 2025 and that company fundamentals will be recognised in share prices.

[3]Source: NSE, as at 29 November 2024.

China: policy support and valuation opportunity

China will be a key determinant of EM asset class performance

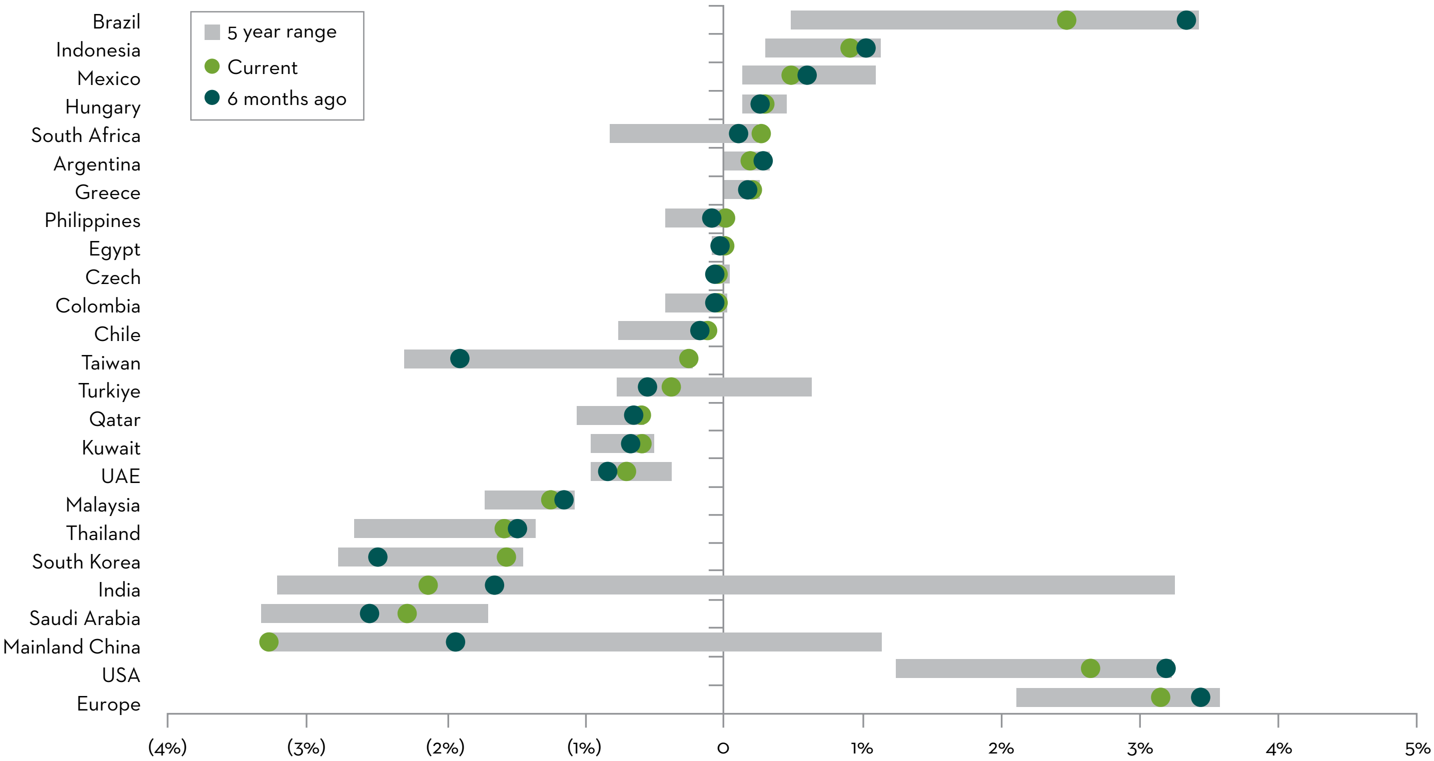
China remains a dominant part of the asset class, representing more than a quarter of the MSCI EM weight.[4] While negative perception and risks persist, we have already seen a significant recovery in Chinese equities. Since the market's trough on 22 January 2024, the MSCI China index is up 34% year-to-date.[4] This has largely been driven by:

- The market recognising company fundamentals and their operational delivery
- Positive sentiment around the coordinated stimulus announced in Q3 2024[5]

EM investors are significantly underweight China

EM investors' allocations to Chinese equities are at five-year lows. This likely reflects continued concerns about market volatility, regulation, and, more recently, uncertainty regarding potential trade tariffs from the US. While there certainly are headline risks to the Chinese economy relating to proposed tariffs from the US under its new administration, this risk equates to just 0.5% of listed Chinese company earnings.[6] The Chinese market is dominated by the digital economy and other largely domestic-focused businesses.

Country active weight exposure for EM funds



Source: HSBC, GEMs stock positioning: Mainland China rally is still the pain trade, 15 October 2024, page 5.

> While negative perception and risks persist, we have already seen a significant recovery in Chinese equities.

[4]Source: FactSet as at 27 November 2024.

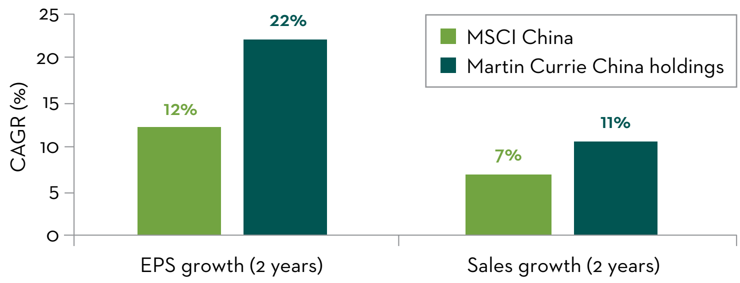
[5]Source: BBC as at 24 September 2024.

[6]Source: UBS Research, Global Economics & Market Outlook 2025-2026, page 50 © 2024 UBS. All rights reserved. Reproduced with permission. May not be forwarded or otherwise distributed.

Chinese companies are projecting strong growth but remain at a significant discount relative to EM and their own history

China is expected to deliver strong earnings and sales growth; we have focused on Chinese names with a more domestic orientation, and we continue to track the potential US revenue exposure for our holdings. Despite these positive signs, Chinese equities are trading at a 12% discount to their own history, and more than 2x greater discount to their historic average relative to EM.[7]

Two-years sales and earning growth



Source: FactSet, as at 25 November 2024. EPS and Sales Growth measured using the CAGR from 1 January 2024 to 31 December 2025.

Our exposures are aligned with structural growth trends, including digitisation, healthcare, green energy and financial inclusion. We see strong growth rates at our held companies. We believe they have broad-based, diversified pools of growth to source from, and that their growth destinies are not intrinsically linked to general Chinese growth.

We believe China is only at the beginning of its recovery. Their equity markets are displaying promising growth over the next few years and, combined with the significant underweight allocation to China across EM investors, and the significant valuation discount at which the equities are trading, we believe there is a significant upside opportunity in 2025 as share prices normalise. Although risks remain, most especially in the potential for trade tariffs imposed by the US administration on Chinese imports, we believe that companies will be able to adapt as they did in the previous Trump administration. Allowing for short-term volatility, we are confident that our Chinese holdings have robust fundamentals and can still deliver despite the risks. We look forward to seeing how the dynamics evolve in 2025.

[7]Source: FactSet as at 27 November 2024. Valuation measured using Next Twelve Months (NTM) Price-to-Earnings from 1 November 2019 to 31 October 2024 for MSCI China and MSCI Emerging Markets.

Key risks

While we believe the long-term case for EM is positive, we acknowledge there are risks that could lead to volatility in the shorter-term. In our view, the key risks to our 2025 outlook are the following:

Increased geopolitical tensions: Protectionist policies from the new US administration could lead to elevated inflation, higher interest rates, and a stronger dollar. Already, the market has begun to price in this negative scenario despite lack of clarity of a final outcome. While many countries could be affected by tariffs, China has been a key focus of the Trump administration. However, given that US exports represent less than 3% of China's GDP, the potential tariff impact to Chinese equity earnings is limited.

Weaker recovery in China: Expectations have been building around significant policy stimulus in China however there remains a risk that the policy responses continues to underwhelm the market and domestic economic activity remains subdued. We believe the Chinese authorities will provide additional stimulus required to support the economy in line with the developing policy pivot.

Softer demand for AI: Capex growth could disappoint, affecting the semiconductor industry and the broader AI ecosystem. Of all the AI-related companies, we expect IT hardware holdings to be most vulnerable to a slowdown. However, in our view the long-term demand for AI is durable and should broaden further.

Long-term investment outlook for EM is positive

We firmly believe that the long-term investment outlook for emerging markets remains robust, and we maintain strong confidence in our portfolio holdings. The market persistently undervalues high-quality, sustainable growth companies, and we are convinced that, despite the recent, prolonged style rotation, investing in these companies will yield positive results in the long term.

Looking ahead, we are particularly excited by the powerful synergy of technology adoption, urbanisation, and services-sector growth prevalent in emerging markets. We anticipate that our highly selective, stock-focused strategy will thrive by identifying companies with high returns on equity, operating in structurally growing sectors. Furthermore, the current environment - with its regulatory pressures, human conflicts, and ever-evolving macroeconomic landscape - highlights the importance of focusing on strong sustainability and governance characteristics, and sustainable growth as critical factors in determining which companies will remain relevant and lead the way in the long run.

As we progress into 2025, we think the key drivers of EM returns, and thus the biggest opportunities, will be technology, India and China. Technology companies in EM are core to the global adoption of AI, and the longer-term structural growth opportunity of EM IT is broader across the whole ecosystem. This should place them well to succeed in the next 12 months and beyond. Similarly, India has had an interesting 2024 and we think that as the market returns to recognising fundamentals in share prices, there may be a market correction which benefits high quality, sustainable growth companies. Finally, as the largest country in the asset class, China will continue to play a key role in the shape of EM and we believe its recovery has only just begun.

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