Demographic change, accelerating economic reform and a growing middle-class consumer base continue to buoy emerging market investment prospects despite wider sector volatility, according to Newton Investment Management (Newton) manager Robert Marshall-Lee.

Marshall-Lee, who leads Newton’s emerging and Asian equity team, points to the growing differentiation between emerging markets (EM) and believes strong pockets of value are now appearing in countries such as India, the Philippines and China, which is still recovering from major market volatility dating from 2015.

“While the last few years have been very difficult for emerging markets, against a backdrop of a strengthening dollar, weakening emerging markets currencies and rising EM bond yields, more recently we have seen a reversal of fortunes,” he says.

“In recent months, the likes of China and India have enjoyed robust GDP growth and are seeing economic growth internally driven by population growth and improvements in underlying productivity. Despite the huge amount of noise about problems in China and a lot of very misinformed analysis on emerging markets, there is value to be found by investors who look beyond the short term to longer time horizons.”

While the previously beleaguered Brazilian economy has also shown tentative signs of recovery, Marshall-Lee sees stronger potential in markets such as India and China.

“In the short term, Brazil markets had been bouncing back quite aggressively, but we don’t think that will be sustained and are more interested in some of the long-term trends in India, the Philippines and China—which is currently witnessing a major economic rebalancing from a manufacturing-led economy to a more consumer-oriented one,” he says.

REFORM AGENDA

Marshall-Lee has been particularly impressed by the latest round of Indian economic reforms, led by its prime minister, Narendra Modi.

“The Indian government is doing all the right things for the long term and
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is not just going for the quick wins, instead aiming to put the country on a long-term sustainable growth path. We are very positive about India and optimistic for its prospects over a five- to ten-year horizon. It is also a more internally driven economy, hence less reliant on exports to the West,” he says.

Among the wider trends facing EM economies, he predicts growing state intervention across markets, with some governments shifting to a more protectionist approach. Following the recent U.S. election victory of Donald Trump—who has expressed pro-protectionist views—Marshall-Lee points to potential impacts of a Trump presidency in Mexico but says he believes the effect on many other emerging markets could be limited.

“While the initial reaction was negative for Mexican equities/peso, along with other EM currencies, emerging markets less U.S.-exposed and less dependent on global financial flows—such as India and Eastern Europe—should be more robust,” he says, adding that much of the negative impact is priced into markets and currencies very quickly and may be over-discounted.

Looking ahead, Marshall-Lee also points to the potential disruptive influence of evolving technologies.

“The likely future impact of new technology on the EM sector is hard to predict and the development of areas such as artificial intelligence, cloud computing and big data, means it is important that investors consider their likely impacts on markets five or ten years out. However, we do believe disruption could present growth opportunities in areas such as Chinese Internet and Web development.

“Markets are also changing fast. Ten years ago, mobile phone companies were a growth area. But markets have moved on and now increasing competition and tighter regulation are leading to declining returns on capital, shifting the focus to other technologies,” he adds.

Commodity Switch

Assessing some of the broader economic themes facing EM economies, Marshall–Lee believes commodity markets are oversupplied and that the era of a booming EM commodities sector is unlikely to be repeated over the coming decade.

From a future growth perspective, he also sees rising emerging market incomes driving new investment in areas such as private healthcare.

“The development of burgeoning middle populations in China and India means that increasing portions of the population have more money to spend on areas such as healthcare and many areas of the market are significantly under-resourced. We believe this presents an emerging market healthcare opportunity going forward,” he concludes.