Emerging market fortunes are not intertwined with commodities or tied to the U.S., says Rob Marshall-Lee, Newton Investment Management’s global emerging markets equity manager. He outlines why there is reason to be positive on developing economies and what sectors could be beneficiaries of change.

Emerging markets (EM) have evolved from the commodities story resulting from China’s industrialization and are now more linked to next-generation sectors, such as education and health care, says Marshall-Lee. Reduced, yet still significant, commodity-driven elements of the MSCI Emerging Markets Index hide divergent structural growth trends which an active manager can focus on and seek to exploit fully, he says.

“In the mid-2000s, EM was all about China’s industrialization—it was a rising tide that lifted a lot of boats. It also benefited a lot of value strategies. But that growth has flattened and is not the EM story anymore. Today, China is led more by consumer services than exports. It cannot sustain the level of fixed-asset investment it underwent, but growth continues in consumer areas.”

People in China are not just getting richer, they are getting older and they are no different there than in the West, spending money on health care and education, Marshall-Lee says. Interestingly, a lot of money is increasingly in the hands of young people in China, so there is also increased travel and rather than being desk-top computer-based, the younger generation in China is more into mobile-Internet devices, he notes.

While this may lead investors indiscriminately towards technology and telecom stocks, Marshall-Lee believes the key is to understand where the value accrues. This, he says, means that at times he will superficially pay up for a holding via a higher near-term valuation multiple.

While EMs may have benefited from the rise of globalism, it is the current increase in populist rhetoric seen across the West that appears to be cause for caution for emerging markets. However, Marshall-Lee argues that need not be the case. There is a threat of protectionism and trade wars, but he has positioned the Newton global emerging markets strategy away from those areas he believes could suffer. In addition, he adds: “Despite tough talk, we see muted action from Trump, and EMs continue to perform strongly. There may be a lot of noise about ‘America first’ but the reality appears a lot more tempered.”

Marshall-Lee says he favored Mexican positions in November on the back of lower valuations, remains cautious on Brazil despite its bounce and maintains India would remain as a large overweight exposure. “I still think it will be the best-performing equity market over the next five years.”

“We believe all bodes well for emerging market investing from here,” he says. “However, we continue to believe a diversified, active portfolio is best suited to these markets, which require a discerning eye. The MSCI Emerging Markets Index has 10% exposure to Chinese banks, something we won’t touch; some 25% of the index is state-controlled whereas we have zero. Instead, we prefer consumer stocks.”
BNY Mellon Investment Management is one of the world’s leading investment management organizations and one of the top U.S. wealth managers. It encompasses BNY Mellon’s affiliated investment management firms, wealth management services and global distribution companies. More information can be found at www.bnymellon.com.

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INDEX DEFINITIONS

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