Baillie Gifford™

Emerging Markets
Q4 investment update

January 2024

Investment manager Mike Gush and investment specialist Andrew Keiller give an update on the Emerging Markets Leading Companies and Emerging Markets All Cap strategies covering Q4 2023.

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Andrew Keiller (AK): Happy New Year, everyone, and welcome to our first emerging markets video update of 2024. I'm joined today by Mike Gush. Mike's one of the senior investment managers in the Emerging Markets Team. We'll look back on 2023. But more importantly, look forward on 2024 and beyond.

2023 was a year that started with a lot of hype around China and the reopening, and we saw a very sharp market rally, followed by a sharp correction when economic data disappointed and for much of the year, returns from China have been weak.

If you look at the rest of emerging markets, returns have been very good. And so in aggregate the EM returns for 2023 were decent. If you'd taken China, the returns would have been stellar. Mike, Can we start by reflecting back on 2023? And also can you give us some comments on investment performance as well, please?

Mike Gush (MG): Yeah, thanks, Andrew. It's really nice to be able to talk about a more positive year for clients. Certainly after the last couple of years where there have been significant challenges for EM growth investors, be it rising rates in the face of higher inflation in developed markets or the Russian Ukraine conflict. So very pleased to be able to talk about a better story.

And really nice to see that it's coming through in the operational performance of our companies. If you think about ecommerce, Mercado Libre, posting stellar results and, you know, names like CEMEX in the materials space. So quite a broad spectrum of types of companies that are delivering better results. But as you say, China has been a really difficult spot.

We've had an underweight to that market, which has been absolutely the right call. And in overweight to Latin America, which is has done very well for clients and that the tone of the debate is whether or not that remains the right positioning going into 2024.

AK: Thanks, Mike. I'll come back to talk about China a bit more. But before we do that, whilst were on performance, I wanted to ask about First Quantum Minerals, which has been the largest detractor from performance. Can you tell us what's going on with that one?

MG: Yeah. So First Quantum Minerals is a copper producer. It's operating across two main countries, Zambia and Panama, and it's an issue with the latter that's caused the problem. Now, we're still very positive about copper as an industry overall, we think there's a very tight supply-demand balance and indeed this actually makes it even tighter. But you've got one of the main growth assets in emerging markets has had to go offline.

Now, the reason for going offline is the has been a public challenge to the mining licenses. And this is something that's held up in the courts. It's a very political issue. And that being the case, it's likely to not be resolved until after the elections in mid-2024. And at the moment, the share price correction has really taken any value for the Panamanian asset out of the share price.

And this is an asset that the company is invested multibillion dollars in, almost $8 billion in. It's a big contributor to both GDP and the fiscal coffers within Panama, second only to the Panama Canal. So it's a really important asset. And at the moment, there's no value in the share price. So potentially you're holding a company which is which has got a huge source of hidden value in that.

So we think patience is the right virtue to have at the moment.

AK: Thanks, Mike. That's really helpful. So so let's go to China. As flagged before, if you look at the stock, the stock to stock performance, it's been very mixed for Chinese companies. If you look at the absolute returns, they've been weak. Can you give us a sense of the team's discussions on China as a whole?

MG: China has remained a very policy driven market, so we've been talking for quite a number of years about regulation and some of the challenges, particularly in the technology space, and that's continuing. Even over the past 24 hours, there have been more regulation coming down on the gaming sector in an area that we were hopeful that we were through the worst of that regulation.

So it remains very policy driven and we've got to be very cautious around that. Areas that have been in the crosshairs over the last year, [for example] property [and] healthcare, have been areas we have had relatively small exposure for the portfolios. And, looking forward, we're a bit worried about how that regulation creeps into the financial sector.

So, again, an area where we haven't historically had a large position for the portfolios overall. The other angle to say on China is that geopolitics is never far from the headlines. Both the tensions with the US and also the position on Taiwan. And both of those appear to be developing into a more constructive narrative going into 2024. But it's something we'll have to keep a very close watch on.

It is the balance between the stock specifics, where many individual companies are posting good operational performance. So that's on a very positive. But some of the challenges with domestic policy and geopolitics that are informing our underweight position in that market at the moment.

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AK: If you look at the other side of the absolute return spectrum, we've got India, which has done very well as a market over the past year or so. Can you talk to us about the team's thinking on India?

MG: Well, in a word, it's still very expensive. You know, it went into the year looking like a quite expensive market relative to the growth on offer. And certainly in the mid-cap space, which has been driving quite a lot of the market performance, it has gotten even more expensive with no real shift in that underlying growth rate.

So, yes, there are some great companies. We own the likes of Reliance Industries or names in the IT service space, names in the banking space - all very exciting, good valuations - and they really haven't budged in terms of their valuations, despite operational performance doing quite well.

So I think quite a lot of that performance has been driven by capital flowing out of China, perhaps into India on one level. But for us, we're actually finding much better growth potential, at better valuations, elsewhere in the emerging universe, particularly in Latin America.

AK: I think as we talk about the divergence in returns and potential from different markets, it's worth reflecting as well on the discussions we've been having with our clients about Emerging Markets Ex China as an asset class, I think the nature of emerging markets as a whole is evolving such that many are thinking about excluding China.

And that's for two reasons. One is due to China risk. We don't want to invest in China, but we don't want to neglect the rest of emerging markets. The other is actually we want to have a dedicated allocation to China, but we don't want to neglect the rest of emerging markets. So this idea of splitting up emerging markets is becoming more common in our conversations.

I would say at the moment, that this is a lot of discussion, but not a huge amount of action. Most still seem inclined to let their emerging markets manager make that asset allocation call between the two, but that may well evolve over time. I think while we're talking about asset allocation calls, it's also worth just reflecting back on the last decade or so of emerging markets returns, which have been very disappointing.

We've recently published a white paper called *Emerging markets: why bother?* Which goes into to the views on the asset class and our reasons for continuing to be optimistic. But Mike, I wondered if you could share some thoughts on the asset class as well. Why is it that you remain constructive on EM?

MG: Yeah, I'd say I'm pretty positive, you know, more so than just constructive. I mean, we've got all the ingredients in place, all the fundamental factors that we need, and really it's just a return to animal spirits. So, emerging markets on the whole, [whilst] there are obviously some fringe cases, but on the whole are in a pretty good position.

Growth rates, fiscal positions. We haven't been through the severe inflation cycles or interest rate rises of many developed markets. And so actually a lot of emerging markets are in rude health, but companies are performing very well to finding ever more world class companies in emerging markets and that's a really good barometer for sort of quality improvements. So quite exciting on that front as well.

And then valuations are really low. Particularly versus developed markets, but on absolute basis as well, we're finding lots of great ideas in emerging markets. So like I say, all the ingredients are there and really it's just that return to animal spirits [that] you need.

There are a couple of structural themes that are coming in that I think are interesting. On the technology side, a lot of what's happening in AI and with Chat GPT, well, the picks and shovels for all of that [are in] emerging markets. It's TSMC, it's Samsung, it's SK Hynix on the memory side. So really exciting.

And then if you think about the green transition and the energy transition, again, a lot of the materials or technologies are coming from emerging markets. So there's a couple of a couple of really quite exciting reasons why emerging markets might capture the zeitgeist going forward.

AK: Yeah, that's a really good note on which to end I think, Mike. A really positive case for EM as a whole and highlighting the fact that that enthusiasm is taking a broad form in terms of the portfolio positioning. So thanks to everyone for watching. I hope this has been helpful. And if you do have any questions, then obviously don't hesitate to get in touch.

Thank you.

Emerging Markets (including Emerging Markets All Cap and Emerging Markets Leading Companies strategies)

Annual past performance to 31 December each year (net%)

	2019	2020	2021	2022	2023
Emerging Markets All Cap Composite	27.9	29.9	-8.5	-27.1	14.2
Emerging Markets Leading Companies Composite	30.8	35.9	-8.3	-26.0	11.0
MSCI Emerging Markets Index	18.9	18.7	-2.2	-19.7	10.3

Annualised returns to 31 December 2023 (net%)

	1 year	5 years	10 years
Emerging Markets All Cap Composite	14.2	4.8	4.6
Emerging Markets Leading Companies Composite	11.0	6.0	4.9
MSCI Emerging Markets Index	10.3	4.1	3.0

Source: Baillie Gifford & Co and MSCI. USD. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite.

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