Baillie Gifford™

Emerging Markets
Q4 investment update

January 2025

Investment manager Will Sutcliffe and investment specialist John Rae give an update on the Emerging Markets Leading Companies and Emerging Markets All Cap strategies covering Q4 2024.

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Ben Buckler (BB): Happy New Year everybody from us all here at Baillie Gifford and welcome to the quarterly update for the Emerging Markets Strategies for Q4 2024. I'm Ben Buckler, a member of the Emerging Markets client team, and I'm very pleased to be joined by Mike Gush, who I hope you all know very well by now as the lead manager on our Emerging Markets All Cap Strategy and a partner of the firm.

Over the next 10 minutes or so, the plan is to look at a couple of recent macro and political developments in Emerging Markets. Then we'll look at performance, attribution and what we've been doing in the portfolio. And then we'll leave time just to look forward about the opportunities and the challenges that we have ahead of us in emerging markets.

Mike, I know you will be keener to jump into the companies, but I'm going to try and start you off on the big picture and the three areas that we're getting questions from clients. And that's clearly China stimulus, the implications of a Trump government for various countries within emerging markets, and then finally, just what is going on in Korea. So perhaps I start you off on the China side and see if you've got any thoughts there.

Mike Gush (MG): Yeah, that's great. Thanks, Ben. I think China's really interesting. I mean, you've got this situation where the domestic economy is really struggling to get going. You've had the clampdown on the property side, and that's really, really hurt domestic animal spirits, domestic demand, the domestic economy, and it's really been struggling.

The good news is that President Xi seems very aware of this, and they're trying to stimulate the economy in a very targeted way. We're not seeing the sort of big bang approach that I think the market's looking for, but probably a much more sustainable way of stimulating the economy. And that should be very good news.

We saw a pretty aggressive market reaction to the early days of that stimulus coming through. It's tailed off a little bit but, definitely when the Chinese government has the bit between its teeth, it's not historically been a sensible idea to bet against that. So, on the domestic side, we're actually pretty excited. And that plays into a lot of the companies we invest in.

I think more worryingly or more challenging is what's happening on the geopolitical side. China with the flashpoints with Taiwan, the South China Sea, with the US, and that's much more challenging. So you've got this difficult balance of domestically, things are actually looking much more positive. And we've been closing the underweight on the back of that, but still in a quite measured way, because geopolitically, things are still quite fraught.

BB: Maybe let me tempt you a bit more on that geopolitical front because it is sort of front and centre, particularly with a Trump administration, and it's what clients are asking about. So what in your mind does the Trump presidency do for emerging markets?

MG: Well, I think we've been here before with the Trump presidency. And I think the lesson from last time is just how unpredictable things can be. And I think that's what we should expect going forward. As Trump comes in, the policies or how the US responds to different challenges, almost you're into a guessing game. And that on one side makes it very interesting investing in the world today, but equally much more challenging.

Specifically on China, there's been a very clear challenge to the competitiveness of a lot of Chinese businesses, particularly in the manufacturing space. Trump's been very clear about the use of tariffs, but that could manifest itself in lots of different ways, whether that's more capital that flows into America to build factories or rerouting of supply chains.

So, I think as much as it's a threat for China, there's going to be opportunities elsewhere. And it's certainly not China on its own. Trump's been talking about tariffs to anybody who is importing into the US, capturing Europe, Southeast Asia, Mexico. So I think we're just in for a very volatile period.

And already during the year, one of the reasons Mexico has been quite weak has been some of the angst around a Trump presidency again. But that's all quite well known about. It's going to be the surprises and making sure you hold your views lightly and have an adaptable bunch of companies in the portfolio that's going to be most important.

BB: I think it's interesting when you talk about tariffs coming on China because of Chinese competitiveness. And I think the well told story now that the CEO of Ford has been driving a Chinese made Xiaomi car for the last six months and is reluctant to give it back.

I think it's probably helpful to come back to the big picture and how it's affected both performance and portfolio positioning. But there's the final element of sort of political angst, I guess, that we need to deal with before we get there. And that's just what's going on in China... in Korea, sorry. What are your thoughts there?

MG: Yeah, almost. It's easier to answer the question you almost asked me there with China. In Korea, I think it's, on one level, utterly bizarre. The news over the last couple of weeks, I don't think anyone really knows how this is going to pan out.

It was a surprise to a lot of long-term Korean commentators who we speak to. They almost thought it was fake news when it first broke. It was so unexpected. And speaking today, I don't think anyone's got clarity on what happens next.

You know, for us, I'd say a base case would be you have some sort of political stability over the next three to six months, a leader will emerge, and that hopefully will allow for a more settled environment. But as an investor in companies, does this really matter?

The secular growth we're investing for is still intact. A lot of the companies we're investing in are export related, not domestic. So you're driven by AI or global tech cycles. So it's a different calculus almost. The fundamentals, the operational performance of those businesses, still look pretty good. So you might have a period of a heightened political risk premium, but that might be the opportunity, not the risk.

BB: Thanks. Well maybe I'll try to get you off the macro and the political then and we can get towards the portfolio and the stocks themselves by dealing with the performance side of things. And over the course of the last year, we're probably flat to marginally behind with a sort of softer Q4 there. I just wonder whether you can talk a little bit about the drivers of both of those.

MG: Yeah, it's been quite disappointing, actually. You know, a lot of the companies we invest in have operationally done spectacularly well, and that should be rewarded. And, the likes of those in sort of technology, the AI cycles, the AI thematic, have done quite well overall, you know, the TSMCs or the SK Hynix, and that's been really nice to see.

But there's lots of businesses [that] are performing well operationally, and that's not been rewarded. So if I look to the last quarter, if TSMC has done well, SEA, the Southeast Asian e-commerce and gaming business, that's done well.

But the detractors, MercadoLibre, one of the best internet businesses, globally, I would say, that's had a really tough quarter, but in the face of a very long period of strong performance so that it can be volatile quarter to quarter.

And Bank Rakyat in Indonesia would be another one that's detracted over the quarter. If I step back and look at the year, again, it's those in the AI technology supply chain, some of the internet companies that have done well.

A notable detractor in the face of that has been Samsung Electronics. This is one where the valuations are, this is as cheap as it ever gets for this business. They still have a... they're still one of the leaders in memory, SK Hynix and Micron have maybe got a jump on them for the high bandwidth memory that's needed for AI servers, but ultimately they're still a leader in memory. And they're the number two foundry business behind TSMC, which is performing so well.

So, it's really quite confusing that they, at such a discount performing so poorly against that. But the good news is they've done a management reshuffle, they recognise some of the challenges and they're redoubling efforts to get on the front foot again. So, I think there's good reason to hope that their advantages are still in place and that will shine through going forward.

If I look to other things that have detracted over the year, I'd say India is a place we've struggled with. Valuations have remained very high for what we would term pretty pedestrian growth, certainly lower than nominal GDP-type growth rates. And that really doesn't make sense to us when we look at the opportunities we have in other markets.

So that's been an underweight for a while now. It's been quite damaging to performance, but it's certainly not one we're likely to reverse unless we have a step change in either the rates of growth or valuations.

And then in Latin America, I think that's an interesting case study where you had mentioned earlier that some of the weakness in the face of the upcoming Trump presidency has really affected Mexico.

But Brazil's also been quite weak. Both the peso and the Brazilian currency [have] been amongst the weakest in emerging markets over the last year. And we are a dollar-based investor, and that's what we're looking for, hard currency returns. So anything domestic has not done particularly well. But most of our exposure in Brazil has been the likes of Petrobras or just mentioned MercadoLibre, which have actually held up much better.

BB: Thanks, that's quite a good but quick run around the geographies and the themes that we've got in the portfolio. And it's actually probably quite encouraging for us to see that we've still got a huge number of ideas that are coming in the growth themes, but also across a number of countries as well.

I guess we've just got a couple of minutes to try to look forward from here and wonder whether we can think about the opportunities and the challenges that might lie ahead.

MG: Overall, we're as excited as we've been about the asset class for some time. Emerging markets, yes, it's had a, I'd say, a horrible 10 years relative performance, certainly against the US market. But actually, all the ingredients are there. It's well primed to do well. It's just what's the catalyst?

If I look from a country perspective, fiscal positions are as good as they've ever been. There's no excesses in emerging markets. There's no US dollar debt issues anymore. So we haven't got that fragility that we've had in other emerging market cycles. So it's a very robust starting point.

You look at the companies, we've seen some of the highest quality businesses coming out of emerging markets that we've seen in the last 20 years. If you go back 10 or 20 years, you would have not found businesses of this calibre coming out of emerging markets. Managed in this way with this sort of management teams, this sort of foresight, these sort of balance sheets, attributes, edge.

This is really quite exciting. Valuations are rock bottom. If you look, India might be the exception, but in aggregate, emerging markets valuations are really cheap. As we're saying some time now, as growth investors, we're capturing that growth premium, the quality premium that we always do, not having to pay up for it.

Certainly against the US, emerging markets look incredibly cheap as well. So lots of good reasons. And then you look at some of the thematics that are driving markets. You look at AI, you look at energy transition, you look at the infrastructure build out. Very often it's emerging markets providing the raw materials or the manufacturing expertise in order to deliver on that.
So, a lot of the potential for emerging markets to do well is on the back of some of these very strong multi-year, multi-decade thematics that are coming through. So it really is quite an exciting time to be an emerging markets investor.

BB: I think that's a very positive note to finish on. Thanks, Mike. To all those watching, hopefully that's been a very helpful runaround for the quarter, but with a nod to the long-term focus that we bring to that too. Wishing everybody a happy, healthy, and hopefully prosperous 2025.

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

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

	2020	2021	2022	2023	2024
Emerging Markets All Cap Composite	29.9	-8.5	-27.1	14.2	6.0
Emerging Markets Leading Companies Composite	35.9	-8.3	-26.0	11.0	5.8
MSCI Emerging Markets Index	18.7	-2.2	-19.7	10.3	8.1

Annualised returns to 31 December 2024 (net%)

	1 year	5 years	10 years
Emerging Markets All Cap Composite	6.0	1.0	5.1
Emerging Markets Leading Companies Composite	5.8	1.6	5.6
MSCI Emerging Markets Index	8.1	2.1	4.0

Source: Revolution, MSCI. US dollars. Returns have been calculated by reducing the gross return by the highest annual management fee for the composite. 1 year figures are not annualised.

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