Baillie Gifford™

Emerging Markets
Q1 investment update

April 2024

Investment manager Andrew Stobart and investment specialist John Rae give an update on the Emerging Markets Leading Companies and Emerging Markets All Cap strategies covering Q1 2024.

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John Rae (JR): Hello everyone, my name is John Rae and I sit within the Emerging Markets client team. I'm joined today by a more familiar face, Andrew Stobart, one of the senior investors within the Emerging Markets investment team. It's our job today to give an update on our Emerging Markets portfolios and we'll cover a bit of what the team has been up to alongside performance, positioning and outlook.

Andrew, you've recently been to Saudi Arabia and South Africa and I know the team has been doing lots of travelling, so that's maybe a good place to start.

Andrew Stobart (AS): Hello everyone, yes, colleagues have been in China, India, Taiwan alongside various Latin American conferences during the quarter and I've been to Saudi Arabia and South Africa, so doing a number of company visits in various countries in the world. For Saudi Arabia and South Africa, neither are significant in portfolios at the moment, but each is quite large in terms of the index. Saudi Arabia is around 4 per cent of the index, including the other Gulf countries around 7 per cent and South Africa is around 3 per cent. These trips are very much about challenging negative views on each country.

So, for South Africa, the macro backdrop has been poor for some time. The economic growth rate has been in long-term decline, there's been high unemployment which has persisted, there have been power cuts across the country on a consistent basis as well and poor service delivery by the government as a whole. And elections at the end of May are unlikely to make much of a difference and in particular not lead to the meaningful reform which the country needs. At the micro level, it's a different story. There are several very well-run businesses and many of these I met and I'm planning to do more work on.

Contrast this with Saudi Arabia, which is an economy which has been faster growing at maybe 3 to 4 per cent for the non-oil part of its economy. The economy has been diversifying away from oil into other sectors in a similar way to Dubai, maybe 30 years ago, and if anything in a more aggressive way. The issue here is more at the micro level and the makeup of the stock market, the opportunity set if you like, where the market is dominated by sectors with relatively low growth. The market itself is relatively immature in that many of the companies on the stock market only IPO-ed relatively recently.

So in both countries, plenty of work to do, plenty of interesting businesses and I'll be doing further work on both countries over the next few months.

JR: Okay, sticking with oil, Petrobras has been in the headlines again and it's been weak. The dividend announcement was a disappointment. How are we thinking about the recent news?

AS: I think more that this is nothing new and the market seems to love to worry about Petrobras and ignoring this short-term noise as we've done fairly consistently now for a number of years has been the right thing to do. I'd add two main points.

The first one would be that Petrobras has been very clear as a company that it's focused on its long-term strategic plan of growing its oil production over time and expanding its core energy business and secondly, in our meetings with the company, we've encouraged management to be ambitious in decarbonising the business to generate long-term value. Petrobras is already producing some of the lowest cost and lowest sulphur oil in the world and if it can continue to decarbonise its business, that will be very value-adding.

JR: And what about the rest of the portfolio? I know it's a pretty short time period, but what have the other drivers of performance been this quarter?

AS: Yeah, so apart from Petrobras being a slightly disappointing performer in the short term, it's been another strong period for our semiconductor holdings. So, companies like TSMC and SK Hynix, they've worked through their inventory overhang. They're now benefiting from stronger demand, particularly from AI-related sources. On the flip side in the semiconductor industry, Silergy is still working through its inventories. We still think it will be one of the winners long-term in the Chinese analogue semiconductor space.

And then it's been a bit of a mixed bag in India. Reliance has continued to have strong operational performance. That's been reflected in an improving share price. And Jio Financial Services, the financial services business which span out of Reliance, has also done well. By contrast, HDFC has disappointed. It's seen tougher competition from other banks in India and the merger is proving more challenging to execute on. And this Indian financial position is very much a source of debate within the team.

And then lastly, and encouragingly, there has been better operational performance from some of our e-commerce businesses like Coupang in Korea and SEA ltd in Southeast Asia. And again, their share prices have done better too.

JR: That is encouraging to hear. How have we been positioning against this backdrop?

AS: Fair to say that there have been no monumental shifts in the portfolio. There's still an overarching barbell position with a mixture of structural and cyclical growers. Where we can, we've taken advantage of volatility. We've trimmed TSMC. And one of the additions during the quarter was to Jio Financial Services.

We've also been spending quite a bit of time looking at two frontier markets, Vietnam and Kazakhstan, where we have a lot of interest. I mentioned we are looking at the Indian financial holdings and also looking at the financial positions within the Brazilian part of the portfolio.

And then lastly, First Quantum, the copper miner, it had its mining license revoked last quarter in Panama. We talked about that then. This quarter, it's had a significant financial restructuring, including a $1 billion equity raising, which we participated in. This puts the company in a much better financial place to navigate the challenges of the next few quarters.

JR: You mentioned a couple of possible emerging markets of the future. How are we thinking about markets at the opposite end of the spectrum, I know we touched on this last quarter, India and China have drastically changed their weightings over the past few years. So, China from over 40 per cent at the beginning of 2020 to now 25 per cent. India over the same time period from 8 per cent to 17 or 18 per cent. To me, that feels quite drastic.

How are we thinking about positioning against these really large markets?

AS: Yeah, those shifts are very significant, even by emerging market standards. The short answer is we're underweight in both markets but for different reasons.

In China, in the short term, we think that there are some very attractive companies and valuations are at levels now which look particularly appealing. In the short term, we have seen quite a few Chinese companies return more of their spare cash in the form of either higher dividends or in the form of share buybacks. In the long term, however, we still have concerns about geopolitics in particular, and also about the influence of the Chinese Communist Party in setting policy for the country.

In India, by contrast, we really like the long-term growth story. The economy is one of the fastest growing in emerging markets. We're very excited long term about the prospects for India, and we don't expect much change after the election. So more of the status quo, more of that positive long-term story. However, at the micro level, valuations, particularly in the mid-cap space and in certain sectors, have gone vertical in some cases. In the consumer stable space, for example, companies there sell on price-earnings ratios of up to 70 or 80 times. We just can't stomach that.

So underweight by China and India, we counter that with ongoing overweight positions in IT, in energy, and in Latin America for this portfolio where we see a better combination of growth and valuation.

JR: And how are we thinking about the asset class as a whole? I know we've been bullish for quite some time. Any change to that view?

AS: No change to that view at all, really. We're still very excited about the asset class. I think disappointed that it hasn't been reflected more in share prices, at least yet. Looking at some of the sort of fundamentals, emerging markets have much lower levels of debt than their developed market peers. They have a small and reducing dependence on the dollar for their trade. And GDP growth in emerging markets as a whole is much higher than in developed markets. And that's even true in China. And it's now cheaper to borrow in some emerging markets or in many emerging markets than in developed markets. That hasn't been true for a number of years. Despite all of this, valuations are at all-time lows. And from an asset allocation perspective, therefore, emerging markets look great. And then when you see that this emerging markets portfolio has derated against a backdrop of an improving picture for earnings, it just feels only a matter of time before this portfolio has its time in the sun.

JR: Thanks, Andrew. That's a nice place to wrap up. And thanks, everyone, for watching.

AS: Thank you very much.

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

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

	2020	2021	2022	2023	2024
Emerging Markets All Cap Composite	-17.7	77.3	-20.5	-10.7	10.6
Emerging Markets Leading Companies Composite	-13.0	77.2	-20.5	-8.6	6.9
MSCI Emerging Markets Index	-17.4	58.9	-11.1	-10.3	8.6

Annualised returns to 31 March 2024 (net%)

	1 year	5 years	10 years
Emerging Markets All Cap Composite	10.6	2.8	5.0
Emerging Markets Leading Companies Composite	6.9	3.7	5.4
MSCI Emerging Markets Index	8.6	2.6	3.3

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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