



BARINGS EMERGING EMEA OPPORTUNITIES PLC

Cape Town, South Africa

Emerging EMEA: the emerging market region you can't afford to miss



Matthias Siller, Head of EMEA at Barings, explores why the emerging markets of Eastern Europe, the Middle East and Africa deserve greater investor attention.

As the world emerges from Covid-19 and assesses the economic cost of the pandemic, these less indebted markets may be better positioned to move forward.

Look inside the average emerging markets investment portfolio and – chances are – it’s heavily weighted towards one region: Asia.

That’s understandable. Asia-Pacific (excluding Japan) has seen annualised stock market growth of around 9% a year over the past 20 years (source: MSCI), giving it an oversized allocation in any global emerging market benchmark. The region’s recent performance has, of course, been dominated by China. Its position as a global powerhouse that’s set to overtake the US as the world’s largest economy by 2030 has made China an essential component in any emerging market strategy.

But being overexposed to any one market or region has its risks. It can also mean missing out on potential elsewhere. A region that emerging market investors can often overlook is what we call ‘Emerging EMEA’ – the developing markets across Eastern Europe, the Middle East and Africa.

Although geographically contiguous, Emerging EMEA may at first sight seem a pretty disparate collection of countries, ranging from Turkey to Russia, Kuwait to Saudi Arabia, to Egypt. But there are unifying characteristics that make this region compelling for any investors seeking sustained growth and income potential. Let’s take a look at a few of them:

The region is under-researched and under-represented

Fund managers and investment houses may assign dozens of analysts to Asia-Pacific, and the global names dominating its markets, such as Alibaba and Tencent in China, Taiwan Semiconductor Manufacturing Company (TSMC) in Taiwan and Samsung Electronics in Korea.

Conversely – aside from the oil and gas giants of Russia and the Middle East – stocks in emerging Europe, the Middle East and Africa tend to command far less coverage.

As a result, there is a diverse array of undervalued opportunities for attentive investors. This can be observed in share prices, where valuations in some instances, most notably within the technology sphere, are looking increasingly stretched. Shares in the Emerging EMEA region are far cheaper and often trade at discounts to their global peers. This offers greater potential for share prices to rise to reflect their true earnings potential, especially in light of improvements in Environmental, Social and Governance (ESG) characteristics.

Many markets enjoy more monetary flexibility...

Unlike much of Asia-Pacific, many Emerging EMEA markets have not historically been dependent on US trade. They therefore haven’t needed to peg their currencies to the US dollar to ensure price competitiveness (the obvious exceptions include the oil-rich nations of the Middle East such as Jordan, Oman, Qatar, Saudi Arabia, and the United Arab Emirates, which do peg to the US dollar).

This gives these markets more flexibility to decide appropriate monetary policy to support their domestic economy and international trade. What’s more, after a decade of depreciation, the currencies of many of these countries are looking very attractively valued with the potential for sustained appreciation – which can add to performance once returns are translated back into pounds sterling.

Emerging markets or less developed countries may face more political, economic or structural challenges than developed countries. Coupled with less developed regulation, this means your money is at greater risk.

...and they're less indebted

Emerging EMEA markets generally have low levels of personal, business and government debt. This means they are less affected by global currency and interest rate movements that can drive up the cost of borrowing. As the world emerges from Covid-19 and assesses the economic cost of the pandemic, these less indebted markets may be better positioned to move forward.

They're only at the start of the global e-commerce revolution

In the West, we've seen how the seismic shift to living, working and shopping online has driven many aspects of stock market growth over the past decade – not least the formidable performance of stocks like Facebook, Alphabet (owners of Google) and Amazon. But many markets in Emerging EMEA are only at the start of this journey.

What's more, it's not just the big global names that are benefiting. So-called 'local champions' in sectors spanning social media to gaming, food delivery to finance are often the preferred local brands. From e-commerce platform Allegro in Poland to TCS, the first fully online bank in Russia, there are a wealth of homegrown companies ready to foster easier consumption, digital payment and online delivery.

They're at the heart of the global energy transition

Russia and the Middle East's dominance in fossil fuel production may seem to put them at a disadvantage in a world looking to wean itself off carbon. But a global transition from oil and coal to natural gas as a cleaner, 'bridging' energy source will benefit Russia and Qatar – two of the world's top four gas producers. This is especially prevalent in the context of the current energy transition sought by the European Commission, in which natural gas represents a readily accessible alternative to reduce greenhouse gas emissions and help combat global warming.

They're naturally good diversifiers

While much of Asia-Pacific made its wealth initially as exporters, many economies of Emerging EMEA (aside from the big energy producers) are domestically focused, and therefore insulated from the fortunes of other economies. This also means they have relatively low correlation with one other. So when one market in an Emerging EMEA portfolio may be slowing, others may be stable or on the rise – helping to balance out portfolio risk.

They're positioned for both growth and income potential...

By focusing on cash-generative companies and sectors, we are able to position our Emerging EMEA strategy to target an attractive income yield without compromising on the long-term growth potential associated with emerging markets.

In addition, the portfolio's broad sector and country exposure should help diversify underlying political and economic risks, while our fundamental bottom-up investment approach helps to unearth unique investment opportunities in what we think is an under-researched region.

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... and seeing more local investor participation

Interestingly, it's not just overseas investors who are cottoning on to the long-term attractions of these markets. The combination of rock-bottom returns on bank deposits and accessible ways to invest online means that more and more local investors are diverting capital into their domestic stock markets. From Johannesburg to Moscow to Istanbul, increased flows into local equity bourses should provide solid support for share prices looking ahead.

Valuable portfolio addition

Of course, these markets still present all the political, currency and market risks associated with young and developing economies – and therefore demand a long-term investment view to ride out any short-term volatility.

But the different characteristics they present from other emerging markets mean they also offer powerful and valuable diversification for any global portfolio. For investors seeking to position their portfolio to benefit from the major economic trends playing out in the 21st century, Emerging EMEA markets deserve serious consideration.

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