

# Emerging Markets Q2 investment update

July 2024

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Investment manager Roddy Snell and investment specialist Andrew Keiller give an update on the Emerging Markets Leading Companies and Emerging Markets All Cap strategies covering Q2 2024.

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**Your capital is at risk. Past performance is not a guide to future returns.**

**Andrew Keiller (AK):** Hello, everyone, and welcome to your regular Emerging Markets update video. Today, I'm joined by Roddy Snell, who is one of the investment managers in the EM team. We'll get his views on the current investment environment. We'll get some thoughts on recent purchases for the portfolio, and also on performance and more specifically China, which has had better returns so far this year.

So, Roddy, welcome. Let's start by discussing the investment backdrop. How are you thinking about the opportunity set at the moment?

**Roddy Snell (RS):** Sure, thanks Andrew. I've been investing in EM for over 15 years, and I say today is certainly one of the more optimistic starting points. And I do think that's important to state outright because it's really quite easy to be negative. Just look at EM positioning in global funds, which is decade-plus lows, while US markets seem to hit new highs almost weekly.

So why do we have that positive EM outlook now? I'd state three reasons, and I'll call them the three M's: macro, micro, and markets. So for macro, since the start of the pandemic, we've been encouraged by the macro progress made in most major EM markets, and that's despite the record US dollar strength. More broadly, we've really not seen the physical excesses we've had in developed markets during the pandemic. And overall, actually, economic growth is generally very strong. That goes for large markets like India, Brazil, or China, a \$19tn economy growing more than 5 per cent, but also for those growing in importance such as Mexico or Indonesia.

Then at the micro level, we see superior earnings growth across EM for this year and next. But more importantly, we're fortunate to be able to buy into companies that are really at the forefront of

global trends that are growing in importance. AI hardware from Asia, key minerals for the green transition, or domestic champions in the largest countries in the world. And then as for markets, we simply don't think these are appreciating this potent combination of strong macro and micro nearly enough. If you look at the top 10 holdings in our portfolio, it's not hard to spot 40 per cent plus growth rates, \$20bn plus annual capex projects, or record levels of profitability. And when I look at the aggregate portfolio, we're really not having to pay up for these great growth companies. So putting that all together means the backdrop to us is looking very favourable at the moment.

**AK:** Thanks Roddy, that's very helpful. So what does that mean for portfolio positioning? And perhaps you can tell us about a couple of the newer holdings you've taken as well.

**RS:** Sure. Well, positioning hasn't actually changed a huge amount since the last update. It's still broad, representing the fact that we're seeing a wide range of growth companies across EM. The large company bets are still really in Brazil, with MercadoLibre and Petrobras, the main drivers of that, and Mexico. But at the sector level, it's probably worth noting that IT and communication services are about a third or more of the portfolio, and that's largely due to strong exposure to Asia.

When people think about AI, they often go straight to NVIDIA, but that really is not the only game in town. Their top end products are made by TSMC, and then the Korean companies are also particularly important when it comes to AI hardware, so Samsung and Hynix. They're seeing huge demand for memory, especially high bandwidth memory, to the point where they're actually running out of capacity at the moment. And this is leading to huge upticks in profits, especially after the punishing semi-cycle of 2022. There are perhaps two newer holdings worth talking about: Kaspi in Kazakhstan and Luckin Coffee in China. So Luckin Coffee is China's largest coffee chain with about 16,000 stores, it recently even took over Starbucks, and it's just got a fantastic new format of small stores which are nearly all automated so you can order everything on your phone. And that means it can charge about half the price of Starbucks and they can scale rapidly. They had about two and a half thousand stores in the last quarter alone. And when you consider the coffee consumption in China is only about five cups per person a year versus 400 in the West, you can appreciate the huge growth opportunity for the business. The second stock is Kaspi in Kazakhstan. This is the country's leading super app where it dominates fintech, payments, lending and e-commerce. It's used by about 14 million of the 19 million people in the country with a 65 per cent daily active user base. So huge user engagement and pretty much used by everyone there. And it's got a massive growth opportunity. E-commerce penetration is only about 12 per cent. Grocery, which is the big long-term prize, is probably only one or 2 per cent. And they really are the only player in town. They've got a formidable logistics network, they've got the scale and they control payments, finance and retail. So a really very powerful ecosystem. And we're not paying much for that at all. They'll be growing 20-30 per cent for the next few years and they're in a 12 times PE multiple.

**AK:** Thanks Roddy. Let's move to performance so if I look at recent performance a few things stick out. We've seen a short-term pullback in some of the more cyclical areas, but at the same time, we've seen strength in many of the technology companies in the portfolio and we've seen a real

bounce in China. I wanted to focus on the last of these, China. Can you give us your take on just what's going on there and what might have changed or indeed what might not have changed?

**RS:** Yes, so the way I'd characterise this is that we're trying to balance the shorter term opportunity with the fact that longer term challenges do remain, especially geopolitical and demographic ones in China. So, you know, after all the economic challenges and negative sentiment, the government are very keen to support the market. We've got a new nine point set of guidelines that's been released aimed at really providing market support. And these tend to only come about every decade. Companies are also being encouraged to return capital to shareholders, and noticeably doing so via buybacks. We see that in the portfolio with the Chinese internet businesses. And there's also a significant additional stimulus to the property market being announced. I think it's also worth mentioning that operationally, many of these Chinese companies are doing very well. The internet companies, for example, it really is striking to us that as the sector, they've been generating historically high profits with earnings of about 25 per cent over the last 18 months. So overall, it's performing a bit better again. Valuation's generally pretty appealing, but the bar for us to invest does remain high. That's partly because of the risks, but also it's us trying to balance this with opportunities elsewhere in the emerging markets. Unfortunately, there's lots to be excited about elsewhere too.

**AK:** Thanks, Roddy. And, you know, just given those opportunities elsewhere, can we start to round off by just talking about your EM outlook more broadly for the years ahead?

**RS:** Absolutely. Now, if we try and put this in a longer term context, I'd say that in the mid-2000s premium investors, it was really characterised by China's infrastructure boom being really a rising tide that lifted all boats, despite many of those boats not actually being that remarkable. We then faced a period of more difficult macro, but one where the quality of a few select tech businesses really came to dominate EM index returns. And I think today we might now be at a point where investors can benefit from a more resilient macro plus a wider range of quality companies. The quality of tech companies EM has really broadened out, but we should also have confidence in hard asset businesses as well. For example, in energy or industrials. After we've got 7 billion people living in developed countries where economies are growing the fastest. And history tells us that when a country's economy grows, energy consumption per capita will follow.

At the same time, we're also seeing a real resurgence in developed market manufacturing and reindustrialisation. EMs are providing the raw materials and are quite possibly the key beneficiaries. China and India, for example, dominate global cement and steel production. So if we take that all together we really do continue to believe that the prospects for a range of European companies are very strong as a result of these trends and that client portfolios are well diversified to benefit from these ranges of growth opportunities. And the really exciting thing is that much of this isn't being captured today in valuations.

**AK:** Perfect. Thank you, Roddy, again. I hope this was helpful for people. And please do get in touch if you have questions. Thanks for watching.

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

### Annual past performance to 30 June each year (net%)

	2020	2021	2022	2023	2024
Emerging Markets All Cap Composite	-0.7	51.0	-35.9	8.6	14.4
Emerging Markets Leading Companies Composite	3.7	50.1	-34.4	8.9	11.3
MSCI Emerging Markets Index	-3.0	41.4	-25.0	2.2	13.0

### Annualised returns to 30 June 2024 (net%)

	1 year	5 years	10 years
Emerging Markets All Cap Composite	14.4	3.6	4.7
Emerging Markets Leading Companies Composite	11.3	4.4	5.1
MSCI Emerging Markets Index	13.0	3.5	3.2

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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