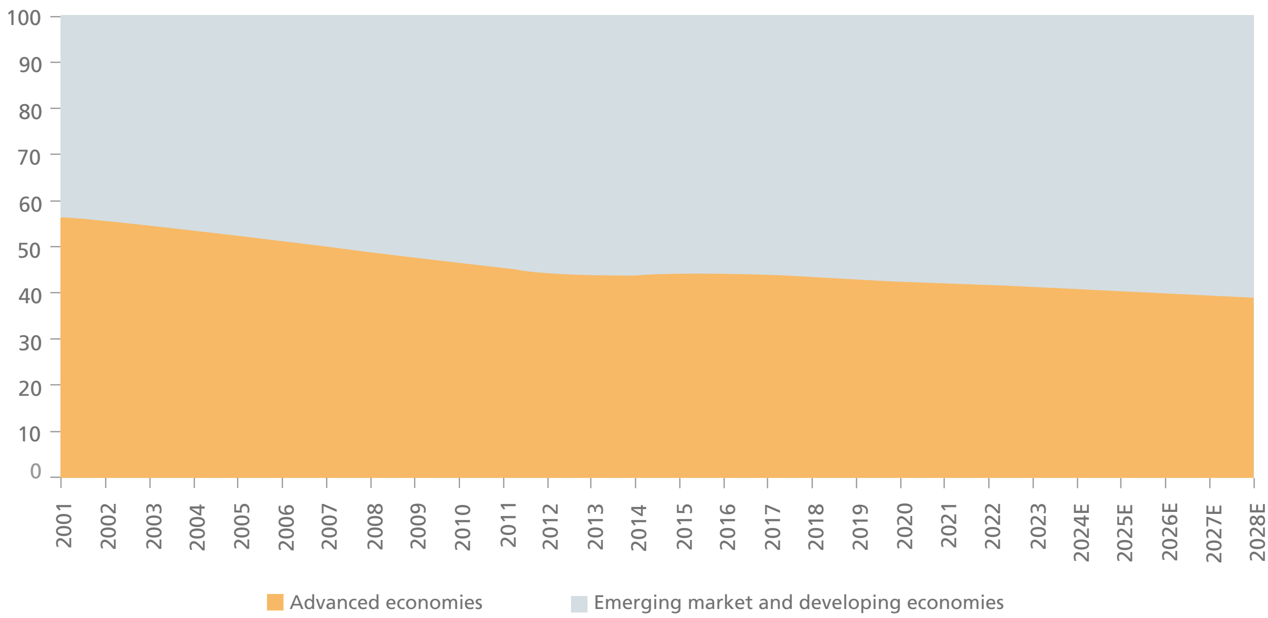
EMERGING MARKETS ARE OFFERING ONE OF THE BIGGEST OPPORTUNITIES IN A LIFETIME

AUGUST 2024

Ox Capital Insights

The term "BRICS" was coined in 2001, and it refers to a collection of developing countries – Brazil, Russia, India, China and South Africa. Since then, the BRICS nations' share of global GDP (based on purchasing power parity) has surpassed that of developed economies, contributing to over ~60% of global GDP. China for example, grew its share of world GDP (PPP) to ~19% from ~8% in 2001. While China's growth is more mature, many other emerging economies are poised to continue the economic catch-up, as these economies still have relatively low-income per capita levels, and growth is driven by sound economic policies.

Exhibit 1: GDP based on PPP, share of world (%)



Source: IMF

Notably, emerging markets equities are at a multi-decade low in price to earnings and price to book valuations compared to that of developed markets. It is an important fact given EM equities have historically outperformed developed market over the long-term. A general lack of interest has led to extraordinarily appealing valuations. We are looking at an attractive entry point with forward price to earnings multiples at depressed levels for quality companies with sustainable long-term growth and a backdrop supportive of outperformance.

Moreover, many EM economies are undergoing continued economic development and political reforms. The economic fundamentals are much better than in prior years. Inflation is trending lower in many EMs allowing central banks to cut rates. A slowing developed markets economy is set to benefit emerging economies as we believe a slowdown in growth for the US will lead to interest rate cuts. Additionally, a declining US dollar and official interest rates are set to benefit emerging market equities.

Exhibit 2: EMs are trading at multi-decade lows ...

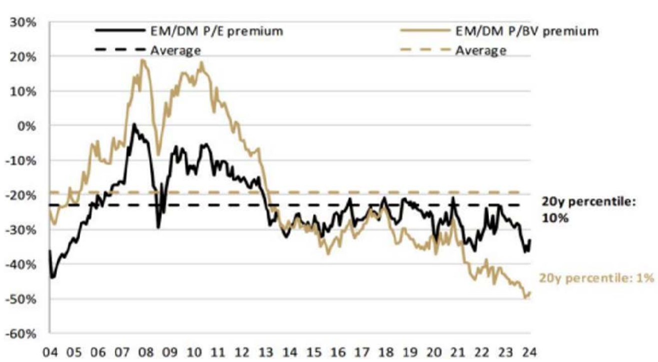
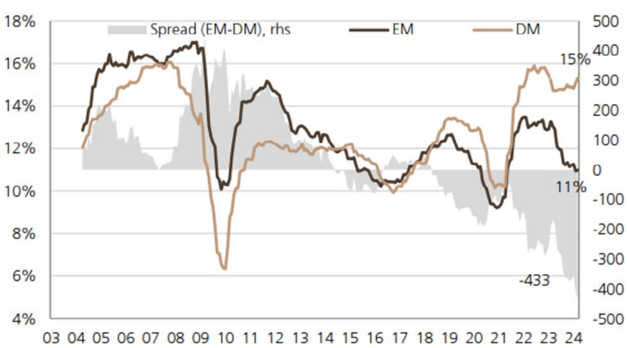


Exhibit 3: ...relative to Developed Markets



Source: IMF

The recent period of underperformance for emerging markets, is an outlier in our view. EM economies were much more indebted and starting valuations were high over a decade ago. The present outlook is vastly different. Fiscal balances are healthy while debt to GDP ratios are at stable levels. Corporates are in a healthy position. Moreover, many EM regions are rich in key commodities for the upcoming Net Zero energy transition. We remain optimistic on emerging markets and believe the fundamentals are in place for EMs to outperform developed economies.

Our proprietary quant model called the Macro Overlay Aggregate Tracker, otherwise called by the acronym the MOAT is pointing to a very difficult environment for many developed markets into 2H2024 into 2025 including the US, versus an improving outlook for many EM countries, including China. Ox Capital is positioned now to benefit by investing in quality companies with sustained growth at attractive valuations across EM countries. In a volatile environment such as the one we are in; it is important to try to hedge the volatility. Ox has the capability to manage the portfolio dynamically that has reduced volatility in the past.

Theme 1: A weaker USD

The US interest rate hikes by the central bank (Federal Reserve) has driven a stronger US Dollar. The recent strength of the "greenback" has been a headwind for emerging economies. This is logical as a stronger dollar can impact capital flows, trade, direct investment, and can impact credit growth. We believe the eventual decline in the USD will provide a tailwind for emerging market equities as returns are typically higher when the USD is declining in value. Historically, EMs outperformed the market by ~20% on average over the period since 2003.

Exhibit 4: USD has been strong...

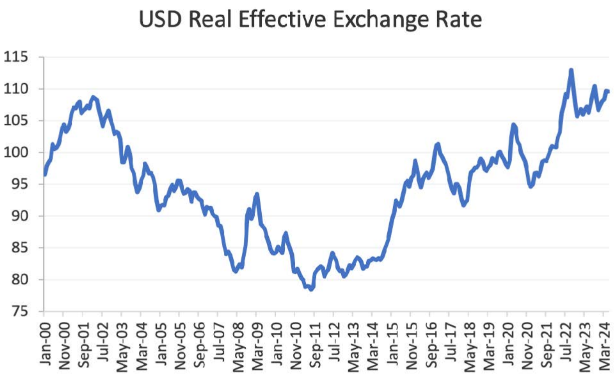
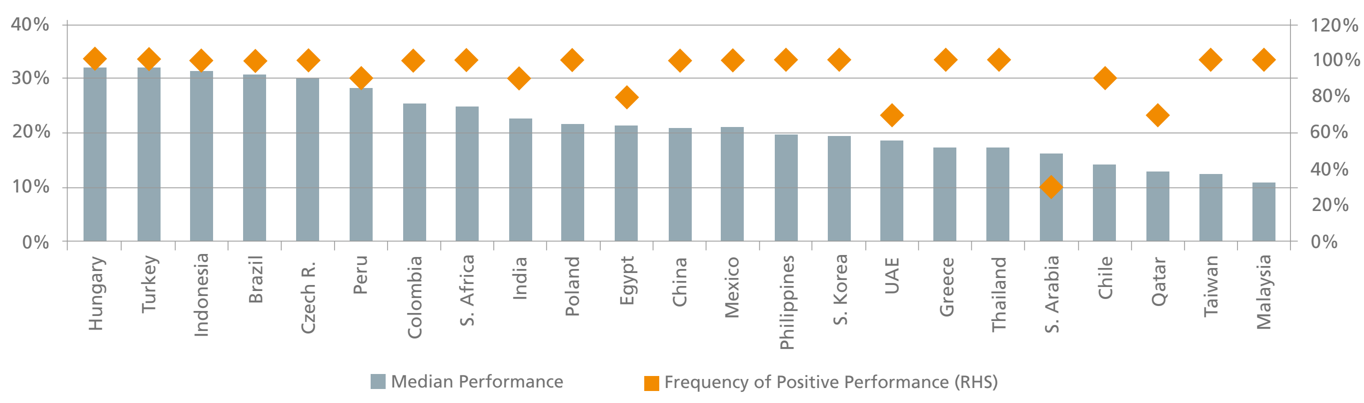


Exhibit 5: ...and EM historically performed well during periods of USD weakness...

Start Date	End Date	# of Days	Broad USD Start	Broad USD End	Broad USD Change	MSCI EM USD
3/21/2003	6/13/2003	82	121.4	114.3	-5.8%	17.0%
9/3/2004	1/14/2005	131	113.2	107.3	-5.2%	19.4%
8/17/2007	11/23/2007	96	102.5	97.1	-5.2%	23.8%
11/21/2008	12/19/2008	28	109.8	104.3	-5.0%	24.5%
3/6/2009	6/12/2009	96	111.7	102.8	-7.9%	61.8%
8/27/2010	11/5/2010	68	101.3	96.1	-5.2%	19.2%
12/17/2010	4/29/2011	132	98.4	92.4	-6.1%	7.9%
1/22/2016	4/29/2016	97	122.1	115.4	-5.5%	18.2%
4/7/2017	9/8/2017	151	122.0	114.2	-6.3%	13.5%
6/26/2020	1/8/2021	192	127.6	117.8	-7.7%	35.5%
Average		**107**			**-6.0%**	**24.1%**
Median		**97**			**-5.7%**	**19.3%**

Source: Ox Capital

Exhibit 6: ...typically with positive equity returns across markets during a falling USD.



Source: JPM, Bloomberg, MSCI

Theme 2: Rate Cuts

The US federal funds rate has peaked and the FOMC is likely to cut rates as inflation moderates within its targets range. EM markets have historically performed well when the US cuts interest rate. Moreover, local central banks have been fiscally responsible. Many central banks have already started to cut official interest rates as inflation has trended back towards many central bank targets. Rate policy looks too restrictive, and cuts are likely to continue.

Exhibit 7: EM index has generally performed well post fed rate cuts

Date of first rate cut ->		10/11/1984	06/06/1989	07/06/1995	09/29/1998	01/03/2001	09/18/2007	07/31/2019	Median
MSCI EM	1y prior		38.9%	-2.0%	-47.5%	-31.7%	41.7%	-4.6%	-3.3%
	6m prior		41.7%	1.0%	-39.6%	-25.3%	24.0%	0.7%	0.9%
	6m post		5.2%	-0.3%	26.9%	-5.7%	-3.8%	3.5%	1.6%
	1y post		25.9%	5.2%	49.8%	-4.0%	-29.2%	4.8%	5.0%

Source: UBS

Theme 3: Supply chain reconfiguration and nearshoring

A reconfiguration of global supply chains will boost economic growth for a number of economies, especially nearshoring in ASEAN and LATAM, boosting GDP growth through foreign direct investments. Vietnam is a notable beneficiary of this trend. Greater foreign direct investment into an ever more open and market driven economy, with some of the most comprehensive free trade agreements in place globally, is providing strong employment opportunities for this young and vibrant country. As such, we believe this backdrop provides a foundation for alpha generating opportunities.

Exhibit 8: Vietnam leads in net FDI inflows/GDP...

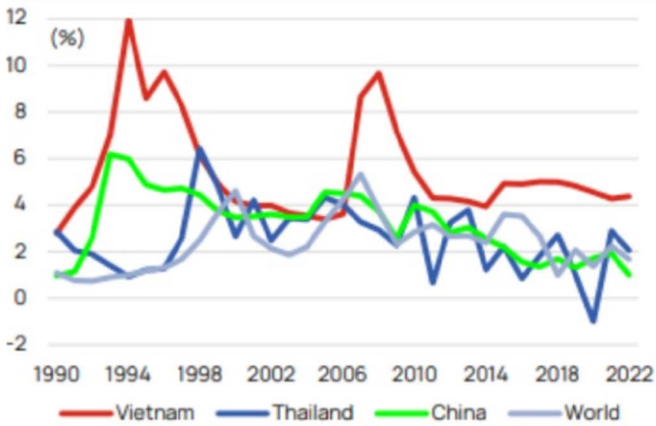
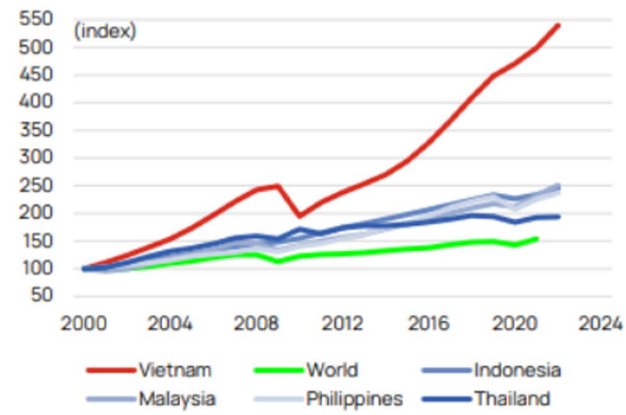


Exhibit 9: ...and manufacturing value add



Source: World Bank, VietCap, IMF

Moreover, nearshoring is a significant opportunity for the LATAM region in the coming years based on their geographical proximity to North America, and relatively cheap skilled labour. Nearshoring could add US$78 billion per annum in additional export revenue in LATAM in the coming years with Mexico being the primary beneficiary. Trade is especially important for Mexico. Mexico relies heavily on its industrial sectors for exports, with the manufacturing sector representing >80% total exports.

Mexico's manufacturing sector has grown and matured over the years. Most recently, the top three export categories include auto-components, electronics, and machineries. Mexico is well placed with its long-established export capabilities to fulfil manufacturing orders for an increasing number of international companies. Mexico's relationship with the US is already well-established, as it is the largest exporter to the US. The country's ~15% share of US imports has now surpassed China's ~14%.

Exhibit 10: Mexico comprised 15% of US imports surpassing China as the top trading partner...

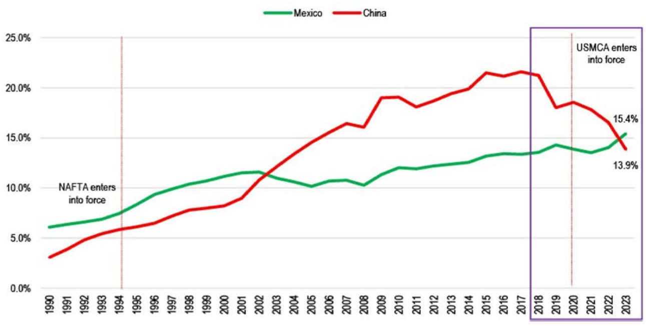
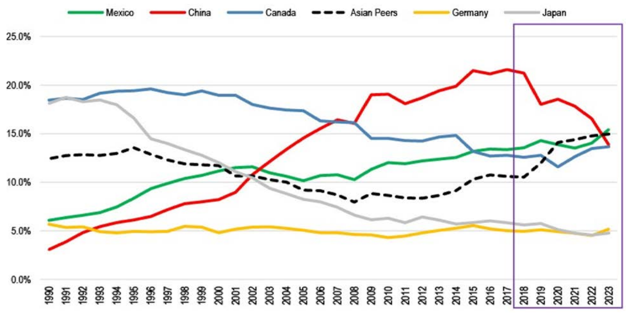


Exhibit 11: ... and slightly ahead of Asian Peers

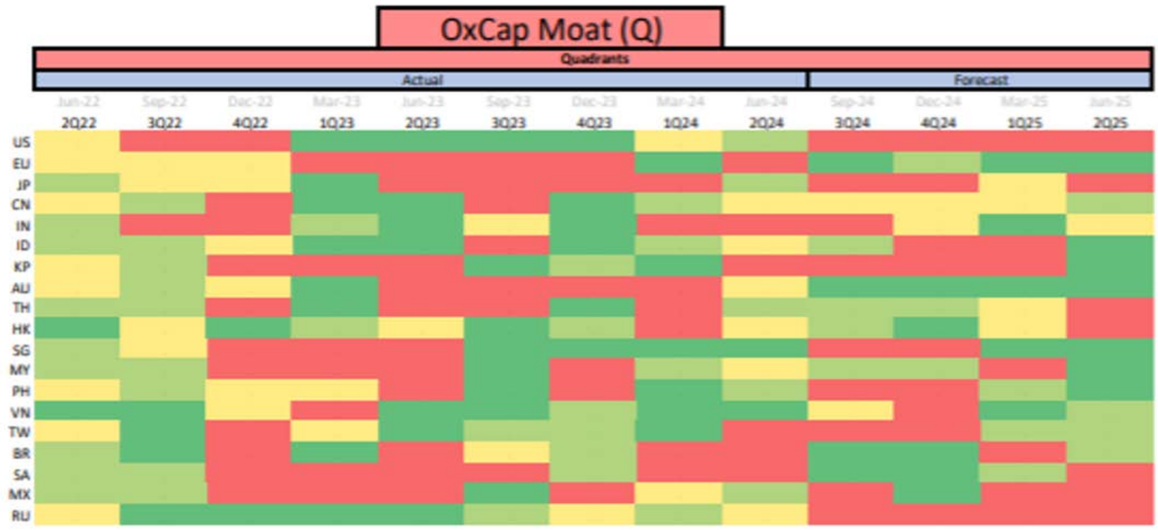


Source: JP Morgan, US Census

Growth in developed economies is expected to slow as rates have likely peaked. In contrast, despite recent economic challenges, the Chinese economy is expected to grow faster than the US, Japan, and Euro Area. Although China's growth is lower than in recent years, its economy is showing signs of bottoming, on the back of the Chinese authorities showing a willingness to stimulate and support the economy. Keep in mind interest rates in China are low with minimal inflation relative to the rest of the developed world. A positive set up for equities in the year ahead. Moreover, Emerging countries make up the bulk of global growth, contributing to over ~60% of global GDP, but is under appreciated by global investors.

Our risk management framework at Ox Capital relies on both quantitative and fundamental, bottom-up analysis along with our experience to deliver actionable, alpha generating ideas. The MOAT, our propriety quantitative model, is pointing to a promising environment for EM growth in 2024, especially China, as inflation in many markets is stable to declining.

Exhibit 12: The OxCap MOAT



Source: Ox Capital Management

We believe we are at an inflection point for EMs and the current valuations are providing an attractive entry point. A declining of US rates and the US Dollar benefit emerging markets valuations. In China, the government is focused on positioning the economy for long term growth. In addition, there is also a greater sense of urgency to support consumption and mitigate risks (such as property and related sectors). The expectation from the regulators is a gradual recovery in 2024 that accelerates in the 2H.

Now is the time to invest and take advantage of attractive valuations for quality franchises with profitable long-term sustainable growth across Emerging Markets.

At Ox Capital, we are focussed on investing in quality franchises with profitable long-term sustainable growth at attractive entry points. Current valuations are providing lots of interesting opportunities. Let us know if you would like to understand specifically where we are finding the opportunities!

MORE INFORMATION

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IMPORTANT INFORMATION

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