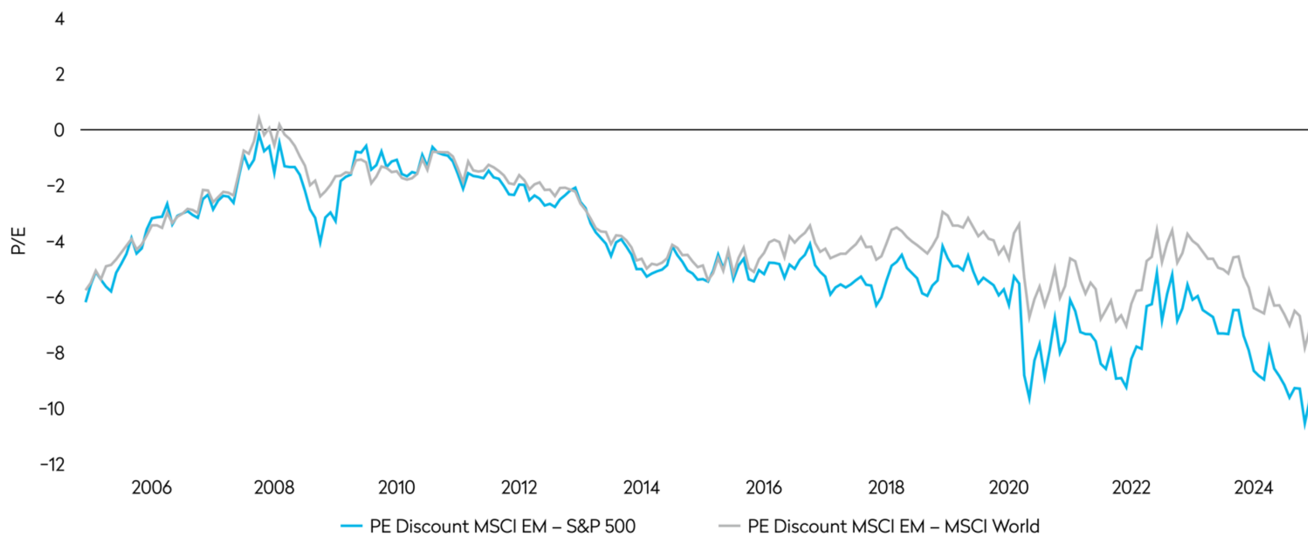
Mondrian INVESTMENT PARTNERS

Year End Emerging Markets Review and Outlook

2024 proved to be another strong year for global stock markets, with growth indices outperforming value counterparts. Within this, and the context of a strong dollar, the MSCI Emerging Markets index returned 7.5%, while the Emerging Markets value index returned a lesser 4.5%.

However, this market strength occurred amid a mixed economic and political backdrop. Global growth is expected to have slowed slightly over 2024, remaining generally below pre-pandemic levels. While US growth showed resilience, China's slowdown continued, and Eurozone growth remained weak. Inflation moderated toward central bank target levels, paving the way for lower interest rates with the Fed delivering 100bps of cuts over the second half of the year. Volatility however spiked episodically illustrating the vulnerability of growth driven markets to interest rate expectations. Despite moderating inflation, persistent components alongside pandemic-era price increases have contributed to rising inequality which in turn has contributed to decisive swings in election outcomes. Emerging Markets saw record voter turnout in 2024, yet by and large these events passed peacefully and without causing significant market volatility. However, it appears that the US election result may have a more pronounced effect on the asset class, given the aggressive stance on trade at the centre of the incoming administration's policy agenda.

MSCI Emerging Markets Discount to the Developed World – Last 20 Years



Source: MSCI

Arguably, one of the most significant developments for the asset class in 2024 was China's shift in policy stance. Chinese equities had suffered a multiyear period of weakness coming into 2024, due to widely appreciated issues both domestically - government interference in the private sector, draconian Covid policies, declining real estate prices and the impact of all of these on consumer sentiment – as well as the country's deteriorating external relations with the United States. These issues depressed sentiment domestically and drove an exodus of foreign capital, as evidenced by widening Hong Kong discounts to onshore shares for the same companies. A key concern had been the government's insufficient policy response to these challenges, but in September, China introduced a large-scale monetary stimulus, targeted directly at real estate and equity markets, which was subsequently bolstered by fiscal measures. These actions, combined with strong central government finances, high household savings, and an innovative corporate sector indicate that China may succeed in stimulating a recovery, should that political will remain persistent.

The Chinese equity market saw strong momentum around policy announcements, possibly indicative of the latent value and low positioning which had built up, ending the year up 19%. During periods of extreme weakness over the past few years the portfolio has at times been significantly overweight the Chinese market. It ends 2024 with a slight overweight position given attractive valuations and potential for further recovery. We have diversified our exposure within China, adding positions in defensive sectors such as rail, telecom towers and a water utility. Notably, and pertinent to our investment style, many companies have further increased shareholder renumeration, with positive responses to our engagement efforts.

India, meanwhile, enjoyed solid economic performance in 2024, benefiting from the reform driven Modi government's focus on infrastructure investment and a growing middle class. Economic growth has exhibited some of the highest rates among emerging markets and political risk appears relatively low, with Modi maintaining high approval ratings. However, caution is warranted in our view. India has historically demonstrated high cyclicality in growth and inflation, and recent GDP data missed expectations raising some concerns about sustainability. Furthermore, while India's long term growth potential may be attractive, the consistency of execution on this growth at the corporate level is more questionable, as evidenced by a significant number of companies missing earnings expectations over recent quarters. The Indian market does not however appear to be discounting much risk of earnings disappointment or poor execution, given that excluding financials, it trades at a PE of ~31x, a clear premium to most markets globally, and its own historical range.

In Q4, the Indian market suffered a decline due to weaker than expected Q3 growth and corporate performance. This coincided with China stimulus measures, which raises the question of a potential capital rotation within the asset class. While we are constructive on India's long-term prospects, we moved further underweight the market in 2024 due to elevated valuations and weak earnings execution.

Taiwan was the strongest major market during 2024, rising ~34%, benefiting from a cyclical recovery in semiconductor demand, but more importantly the emergence of AI capex as a durable demand driver. The return of the Taiwan market was dominated by TSMC, whose strong stock performance this year reflects confirmation yet again that whichever new technology trend emerges, the company's manufacturing is likely to be a key enabler of it, as well as the company's consistent execution on these opportunities. The Taiwanese market however contains many other companies well positioned to capitalise on AI capex, yet most are also exposed to mature areas of technology spend, and with valuations having broadly rerated, we reduced exposure and moved further underweight the market.

Korea, another tech heavy market faced challenges in 2024 as Samsung Electronics' struggles with AI memory technology led to sharp underperformance. Nevertheless, the Korean government's "Value Up" agenda encouraged companies to take action to improve their valuations through a greater focus on profitability, and capital returns to minority shareholders. However, political instability in the wake of now impeached President Yoon's peculiar decision to briefly declare martial law has raised questions about the durability of the agenda, amongst others. We remain overweight Korea, focusing on companies that have already improved their shareholder return policies and are confident this should continue.

Outside Asia, performance of major markets was more mixed, particularly so in Latin America where both the Mexican and Brazilian markets endured steep declines, in each case partly driven by politics which weighed on currency returns. Mexico was the exception to the general trend last year that elections passed in EM without significant market impact. A negative reaction to the strength of continuation candidate Claudia Sheinbaum's "Super Majority" raised fears of a more radical agenda which was compounded by the fear of raised tariffs under President Trump. While not always the case, politically catalysed sell offs in Emerging Markets have often presented attractive valuation opportunities for those with a longer-term horizon, and we cautiously expect that this is the case with Mexico. The new President has so far shown no tangible signs of a radical policy stance, and arguably the incentive to disrupt Mexico's respectable post-Covid economic track record is low. Meanwhile, the Mexican market is home to several strongly positioned domestic facing businesses, where we expect that the direct impact of trade frictions is likely to be limited. The market sell off afforded us the opportunity in Q4 to initiate a position in one of these businesses at 20-year low valuations, increasing our overweight position to the market.

The Brazilian market endured significant volatility, as concerns mounted over President Lula's proposed spending policies and a protracted budget approval impasse in congress. This led to a sharp depreciation of the Brazilian Real which fell 22%, further compounding local market weakness. Brazil is now at historically low valuation levels which we view as a long-term opportunity and consequently have an overweight position believing these depressed levels are unlikely to persist.

Market Level Price to Earnings – Last 10 Years

	MSCI India Index	MSCI Taiwan Index	MSCI China Index	MSCI Korea Index	MSCI Brazil Index	MSCI Mexico Index
NTM P/E	22.8x	16.3x	9.8x	7.9x	7.7x	10.4x
Percentile Rank	93	81	19	3	21	1

Source: MSCI, FactSet
Data as at December 27, 2024
Portfolio Underweights/Overweights are based on the weightings from the Representative Account of Mondrian's Emerging Markets Equity Composite
Weekly NTM PE observations for 10 years to 27th December 2024 for select major markets within MSCI EM. The top and bottom of each grey box denotes the maximum and minimum weekly observation over the 10 year range, the middle bar denotes the mean observation, while the intermediate bars denote the +1 and -1 standard deviation observations around the mean. Percentile rank is the percentile that the current NTM PE observation (27th December 2024) is at within the 10 year range.

Looking forward to 2025, Emerging Markets remain comfortably below previous highs, and trade at a material discount to developed markets. However, the index has enjoyed two consecutive years of reasonably strong returns, bringing multiples back in line with, or above 10-year average levels, depending on the metric. Digging deeper though, significant divergences can be observed. Of the major markets discussed above – India and Taiwan - have rerated to the upper end of their historic ranges and explain most of the recovery in index level multiples, while the others remain somewhere between below and significantly below their long-term average multiples. The portfolio is positioned for mean reversion in these valuation levels with underweights to the former group and overweights to the latter. Additionally, as alluded to earlier, in two markets where we have larger portfolio allocations – China and Korea – we are positioned in companies which are increasingly taking low valuations into their own hands through improved capital returns, either significant share buyback programs or increased dividends. Furthermore, the divergence between the growth and value styles widened in 2024. The portfolio is well positioned for reversion in this, trading on a PE of c.11x and a dividend yield over 4%, significant discounts to the broader index; achieved we believe without sacrificing business quality, as evidenced by the portfolio's slight ROE premium to the index.

In conclusion, while emerging markets face an uncertain economic and political landscape, we remain optimistic about long-term prospects, especially in undervalued markets. Our positioning reflects a focused but balanced approach, with an emphasis on value opportunities in a diversified range of markets, sectors, and industries.

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Unless otherwise stated, all returns are in USD.

All references to index returns assume the reinvestment of dividends after the deduction of withholding tax and approximate the minimum possible re-investment, unless the index is specifically described as a "Gross" index

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