Emerging Markets Insights

COVID-19 Vaccine Advancement Drives Emerging Market Optimism in November

Three Things We're Thinking About Today

1. We are of the opinion that there are a number of high-level reasons to be positive on emerging markets (EMs) based on a combination of a **Joe Biden presidency and a Republican Senate** in the United States. First, we believe this election result is likely to cap US interest rates for longer and therefore weaken the US dollar, thereby inducing a flow of money into EMs, further benefiting those countries. Second, we could expect a softer policy stance toward China. Under Biden, we could see some resolution to the China-US relationship and a form of peace formed between the countries. We believe there could be reduced trade uncertainty as well as less disruptive foreign policy. Should this occur, we feel that the positive impact will likely drip-feed through to other emerging countries. Finally, Biden is seen as an establishment globalist, which means that his election could signal a potential US return to multilateral treaties such as the Paris Accord or the Trans-Pacific Partnership. EMs could also benefit from the United States' entry into multinational and governmental organizations. Overall, EMs are holding strong and are expected to benefit from the Biden win, including better relationships as well as new trade deals.

2. While some countries have backed away from globalization, not all countries are keen to disrupt existing trade relationships. In fact, many continue to seek renewed trade deals, deepening integration with others. Many recognize the benefits of free trade and the need to have rules-based organizations to govern trade agreements. On November 15, China, Japan, South Korea, Australia, New Zealand and the 10 member states of the Association of Southeast Asian Nations (ASEAN) signed the **Regional Comprehensive Economic Partnership (RCEP)**, which some have dubbed "the world's biggest free trade zone." The RCEP represents a significant regional trade bloc, covering about 30% of the world's population and accounting for approximately 30% of global gross domestic product (GDP). The members plan to reduce tariffs on 90% of products to zero over the next decade, fostering more trade within the bloc. Beyond the planned tariff cuts, we are keeping an eye on the status of non-tariff barriers. Less-developed ASEAN nations may see increased imports and reduced exports as a result of RCEP, as it will be difficult for them to develop the manufacturing capacity and/or knowledge to compete with larger countries, like China. As the COVID-19 pandemic continues to restrict global economic growth, this new partnership looks to provide a jump-start to growth.

3. In recent years, international supply chains have come under mounting pressure. As Sino-US rivalry has extended from trade to technology, we are seeing the development of "one world, two systems" in which geopolitical considerations play an increasingly dominant role in driving technology and trade patterns. It is companies integral to **global technology hardware production**—supplying key products to both China and the United States—that may have to be most adaptive. As active, engaged investors, we identify three characteristics that may facilitate success: intellectual property, improving competitive dynamics and global diversification. Semiconductor foundries have been benefiting from the structural

Market Performance (MSCI EM Index, USD)

Cumulative Return

Best	Worst
Greece (30.7%)	China (2.8%)
Poland (28.2%)	Egypt (3.1%)
Hungary (26.7%)	Qatar (3.9%)

Sector Performance (MSCI EM Index, USD)

Cumulative Return

Best	Worst
Energy (16.2%)	Telecommunication Services (1.4%)
Materials (15.6%)	Consumer Discretionary (1.5%)
Financials (15.6%)	Health Care (7.1%)

Currency Performance (MSCI EM Index, USD)

% Change

Best	Worst
Colombia (7.5%)	Argentina (-3.6%)
Turkey (7.2%)	Qatar (0.0%)
Brazil (7.1%)	Saudi Arabia (0.0%)

Source: FactSet, one-month period ending 11/30/20.

themes driving global demand for computing power, rather than being dependent on the fortunes of specific companies—whether Chinese or American. Technological leadership has enabled a virtuous cycle of growing market share that funds research and development and increased capital expenditures. While US tariffs and sanctions have negatively impacted the competitiveness of certain Chinese technology companies, they have created opportunities for others to grow international market share in smartphones and fifth-generation (5G) network equipment. Further, as supply chains fragment, companies with pre-existing worldwide production capabilities will likely demonstrate greater resilience and adaptability.

Outlook

Recent COVID-19 vaccine news has signaled a return to economic normalcy for most EMs sooner than initially anticipated, despite the resurgence of COVID-19 cases in many developed markets. We expect the start of vaccine rollouts next year will drive greater economic activity. Meanwhile, we have seen countries cope reasonably well with the latest uptick in infections, which suggests that the resulting economic impact could be less severe than that during the first phase of lockdowns.

A stronger economic outlook has led to some sector rotation and a significantly larger number of stocks improving in performance. From a longer-term perspective, however, of greater importance to us is the concept of resilience versus vulnerability. We seek companies that display resilience to economic and other forms of disruption. Digital disruption in particular is a trend we have continued to see across a range of industries in EMs. This has led us to favor businesses with distinct competitive advantages in technology and innovation.

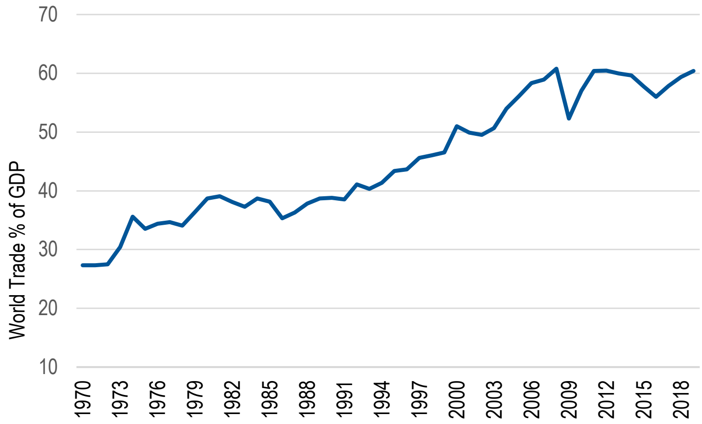
We have also found resilience in leading EMs at the macroeconomic level. We think China, Taiwan and South Korea have handled the pandemic effectively, and we view this as a testament to the quality of their institutions, governance, and health care systems. We believe long-term investment opportunities in India remain intact despite its cyclical slowdown, and the consumption story remains compelling to us. Brazil has emerged from economic challenges in the past and we think the country remains well-supported by favorable demographics and abundant natural resources. Significant new capital market activity and the emergence of technology leaders, particularly with regards to e-commerce and financial technology (fintech), have also buoyed the market.

The US election results could have wide-ranging implications for EMs. We are watching developments across areas such as US fiscal spending, the US dollar, energy-related policies, and trade deals and tariffs. We expect reduced trade uncertainty and less disruptive foreign policy under a potential Biden administration. Nonetheless, our bottom-up investment approach means that our focus stays on individual companies, and how each has prepared for the risks and opportunities that arise from a changing world.

Emerging Markets Key Trends and Developments

EM equities climbed in November but trailed their developed market peers. Positive COVID-19 vaccine development data and increased clarity on US election results fueled investors' risk appetite globally, notwithstanding a jump in coronavirus cases in several parts of the world. Hopes for economic normalization supported a surge in cyclical stocks. The MSCI Emerging Markets Index increased 9.3% during the month, while the MSCI World Index returned 12.8%, both in US dollars.[1]

World Trade as a Share of Gross Domestic Product (GDP)
1970–2019



Sources: World Bank, World Development Indicators; Macrobond.

The Most Important Moves in Emerging Markets in November 2020

- Emerging Asian equities advanced. Thailand and Indonesia were among the top gainers as upbeat global cues sent investors into markets that had lagged the region's year-to-date rally. South Korea's market soared; optimism around trade prospects for the export powerhouse outweighed concerns about increased COVID-19 infections locally. Chinese equities trailed on the upside following their runup in the previous months. Investors weighed robust Chinese economic data and the potential for improved and more predictable US-China engagements under US President-elect Joe Biden's administration against signs of China stepping up its scrutiny of the internet industry.
- A risk-on backdrop and higher commodity prices buoyed Latin American equities and currencies. Brazil outperformed the broader region. Solid economic indicators reflected a continued recovery in Brazil. The country also achieved a current account surplus for October. Stocks in Mexico rallied. Its economy rebounded in the third quarter from the second quarter. A potential Biden presidency also offered investors hope for steadier US-Mexico relations. Peru's market closed sharply higher, overcoming political uncertainty fueled by protests and the departure of two presidents during the month.

- Emerging European stocks logged stellar gains even as COVID-19 cases continued to rise in some European countries. Russia's market benefited from a jump in crude oil prices as progress in vaccine developments lifted prospects for global oil demand. Turkish stocks rallied, as did the Turkish lira. The appointments of new heads for Turkey's central bank and treasury and finance ministry drove expectations for improved economic policies in the country. In the Middle East and Africa region, South African stocks finished higher as investors looked past cuts to South Africa's sovereign credit ratings.

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- **8 years on average with Franklin Templeton**

1. Source: MSCI. The MSCI Emerging Markets Index captures large- and mid-cap representation across 24 emerging-market countries. The MSCI World Index captures large- and mid-cap performance across 23 developed markets. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future results.** MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com.

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