A period of change: emerging markets and Asia

After nearly a decade in the wilderness for emerging markets, we must ask ourselves, is this a dawn of a new era? Is this the decade for emerging markets?

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There is a feeling that we are in a period of change and return to normality, not only in respect of the global economy as a whole, but in relation to the internal drivers of individual markets. This being driven by higher interest rates, leading to more regionalisation and competition between developed and developing nations.

At J O Hambro Capital Management our emerging market fund managers have distinct approaches. We sat down with fund managers, Ivo St Kovachev, Samir Mehta and Ada Chan to discuss the challenges regarding the cost of capital, geopolitical risks, and the opportunities for asset allocators in emerging markets.

Cost of capital: are we going back to normality?

Ivo: We are going back to more normal conditions...when we talk about these countries it is not all about absolute levels, it's about the relative dynamics between countries...

Samir: For the first time in a long time, company managements really need to focus on costs, on working capital, cut back on capital expenditure...we want to find businesses that are managed in an environment where capital has a true cost and where governments aren't going to come in and rescue them. That's a big difference. In our strategy, there are many companies who fit this bill and that can benefit from this operating leverage as we come back to normality.

Ada: We have gone from a period where China was the manufacturing and exporting giant, but with COVID, supply chain issues and challenging politics, companies have to move closer to their demand. This is benefitting countries like Indonesia, Mexico and Eastern Europe. We are seeing different pockets of opportunities that are very different to the past ten years.

Geopolitics: how serious a factor is geopolitical change?

Ada: We don't think China is 'uninvestable'... but you need to align yourself with the Beijing government. Among the key areas we like is domestic consumption...and China has really developed its internal market and foreign goods are not always better. For example, Korean cosmetics were very hot in China, but it has completely changed...during COVID, Chinese brands really picked up....marketing is very different in China as they move very fast.

Ivo: This is a very serious factor...the world is changing...new players are coming into the global supply chain. Oil is being supplied by Saudi Arabia, food production in Brazil and in 2022, the best country in our strategy was Greece. We have developed an accounting system to screen for these issues in every stock, during our consideration stage, and it is critical in our process to avoid these drawdowns.

Samir: Every country is rethinking their supply chains, their vulnerabilities, and trying to rearrange their manufacturing. This 'nearshoring' phenomenon has been recognised by the government as a very large opportunity for Indian manufacturing to take centre stage and perhaps steal some market share from China.

Asset allocation: what should allocators look for in emerging markets?

Samir: I'll touch upon the risks that we should be aware of. Some of them are obvious, geopolitics and the dollar. Some of them we know might happen, some of them the probabilities are low. But certainly, those risks around protectionism, around the geopolitics, around the liquidity of the US dollar would be paramount in my view.

Ada: A weak dollar would certainly be a tailwind for emerging markets, but our approach is really that emerging markets matter at a country level. So picking the right country to invest in and align yourself with those themes within the country is the most important part of our approach, and we believe that's where we generate alpha.

Ivo: We always try to find the best options whether on a country basis, sector basis, certainly stock selection. We do this through a combination of explicit top-down and bottom-up stock picking and opportunities are plenty. For example, nearshoring in Mexico or Eastern Europe.

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