Emerging Markets Growth Perspectives

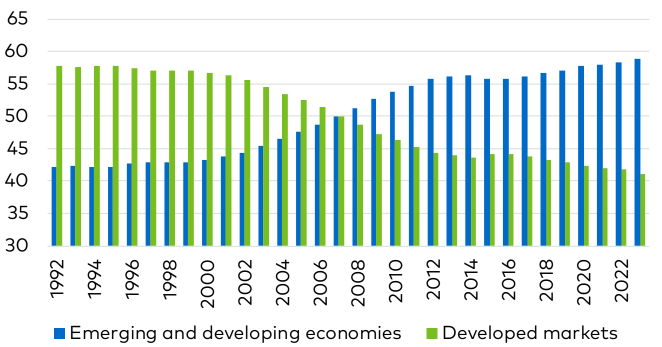
January 2024

Bright Spots on the Horizon

One of the foundational benefits of investing across emerging markets (EM), in our view, is that these countries provide investors with exposure to higher economic growth rates than many developed markets. In the long term, faster economic growth should result in higher population incomes and a larger profit pool for companies operating locally.

Over the past decade, emerging markets have not disappointed on the growth front, accounting for almost two-thirds of the world's gross domestic product (GDP) growth (Figure 1). Hence, emerging markets today represent a crucial engine of global economic growth, with incomes following the upward trajectory witnessed in much of the developing world years ago.

Figure 1: Share of World GDP (%) at Purchasing Power Parity (PPP)



Source: International Monetary Fund, September 2023.

One of the most significant opportunities we see brewing across EM is that while these countries have delivered on their side of the growth bargain year after year, their respective stock markets have trailed behind, resulting in a potentially advantageous entry point for long-term-oriented investors.

Despite these significant developments, we have not seen equity markets perform as we would have expected in the past decade, with the MSCI Emerging Markets index returning just 1.2% annualized by the end of October, compared to over 10% for U.S. equities, according to Bloomberg.

Top-down factors weighed heavily on EM returns in 2023. While this dynamic may persist in the near term, in our opinion, emerging markets should continue to exhibit solid growth. With a reopening of China expected to gain traction—albeit slower than initially expected—we anticipate this may act as a further tailwind for the space. Additionally, we observe attractive secular opportunities in India, where we see ample runway for growth in sectors like financial services. In our view, valuations of what our research indicates are high-quality growth companies within EM remain highly attractive and at a material discount to history and the broader universe.

In addition to the historically attractive valuations seen today across EM equities, we are equally impressed by the leading companies we see across the investable universe that we believe can benefit from the unique secular opportunities of these nations, such as urbanization, income growth, and technological advancement. In our view, some of the most significant future winners across the space include companies harnessing the power across many of these markets and delivering exceptional outcomes through the cycle.

This is particularly evident in China, a market under deep scrutiny in 2023. The world's second-largest economy is still emerging from a severe lockdown, and its recovery is taking time to thaw. The slower-than-expected consumption recovery, turmoil in the property sector, and geopolitical conflicts have weighed heavily on investor sentiment, and we have seen record net outflows from foreign investors so far this year. Nevertheless, several tailwinds supporting the case for a brighter outlook remain in the cards. For example, the country remains at the forefront of technological innovation, there is a vast and still growing middle class, and the economy is going through a raft of structural changes designed to strengthen its position on the global stage.

Looking Ahead in Emerging Markets Growth: Key Takeaways for Investors

While emerging markets have experienced a surge in economic growth rates, rising incomes, and larger profit pools, the market has been ignoring these very supportive fundamental metrics for the past years. As a result, this has created an exciting valuation dislocation for EM equities. Nevertheless, given the possibility of a wide dispersion of outcomes, we do not believe a passive investment approach is warranted.

At Polen Capital, we aim to invest only in the highest-quality growth companies we can find in the world. We seek businesses with durable competitive advantages, operating in structural growth markets and industries. We believe that these two factors—alongside robust governance and prudent balance sheet management—support a company's ability to compound earnings and cash flows at attractive rates of return.

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Polen Capital is a team of experienced investment industry professionals who share an unwavering commitment to our clients, investors, community, and each other. We have been dedicated to serving investors by providing concentrated portfolios of what we believe are the highest-quality companies for more than three decades. At Polen Capital, we have built a culture of results, and in this, an inherent belief in going beyond what's expected for the people and communities we serve.

We adhere to a time-tested process of researching and analyzing companies around the globe—seeking only the best to build highly concentrated portfolios. Then, we invest for the long haul and with a business owner's mindset—giving these companies time to grow.

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The MSCI Emerging Markets Index is a market capitalization weighted equity index that measures the performance of the large and mid-cap segments across emerging market countries. The index is maintained by Morgan Stanley Capital International.

Definitions:

Gross Domestic Product (GDP) measures the monetary value of final goods and services produced in a country in a given period of time.

Purchasing Power Parity (PPP) is the exchange rate at which the currency of one nation must be converted into the currency of another so that the same products and services can be purchased in each country. PPP allows economists to compare economic productivity and standards of living between countries.