Global Asset Management

RBC Emerging Markets Equity Outlook Report 2023

Marketing communication

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Foreword

We are pleased to share with you our RBC Emerging Markets Equity Outlook for 2023.

After what has been a notably challenging year for emerging markets ("EM") equities, we use this report as an opportunity to reflect on the key developments within the asset class and set out our thinking for the environment ahead. We also look to address the key questions and concerns that we have been hearing from our clients.

"Environmental, social and governance factors and sustainability-related reforms are becoming increasingly important for countries in emerging markets."

In this year's report, we cover a broad range of topics, from valuations and earnings, to EM growth, currencies and inflation. We also assess the relative outlook for EM countries, sectors and styles, focusing on those areas where we identify extremes. While our portfolio positioning continues to be driven by bottom-up stock picking and long-term structural views, we use our outlook to increase or decrease country and sector weights at the margin.

We also review developments within our portfolio themes. These themes help position our portfolios in areas of long-term structural growth which we feel is particularly relevant in the new environment, where low interest rates and easy money are now firmly behind us and growth will be increasingly challenging to come by.

Given the substantial weight of China within the MSCI EM Index, and thus its impact on the performance of the overall asset class, we dedicate a chapter to assessing the drivers behind China's recent underperformance and lay out our thinking for its path ahead.

Finally, environmental, social and governance ("ESG") factors and sustainability-related reforms are becoming increasingly important for countries in EM. In this report we highlight some positive developments in specific emerging countries in terms of ESG-related reforms.

We hope you enjoy our insights and we look forward to the year ahead.

Summary

EM performance has been negatively impacted by weak performance from MSCI EM heavyweight China in the last 24 months, with China being the weakest performing EM country up until the end of October. China saw a sharp decline due to a number of factors: regulatory uncertainty surrounding the technology sector, the impact of relatively tight policy, in particular towards the property sector, and the negative impact on growth of its Zero-Covid policy. Looking ahead, we believe that the regulatory issues in the internet sector are now largely behind us, and that the much-improved valuation and expectation of incremental opening up are supportive of improved performance. This has started to play out in November with China staging a strong recovery as the government moves towards reopening. Looking ahead, it is important to be cautious on areas that are vulnerable to negative government policies in China and to be positioned in areas that the government is likely to support, such as renewable energy, electric vehicles and independent technology. As such, selectivity will remain key in China.

Outside of China, our analysis shows that a significant overhang for the performance of EM equities in recent years has been U.S. dollar ("USD") strength[1]. There are several reasons to believe that this may be about to reverse: a peaking in U.S. monetary tightening expectations, a diminution of international risks, and a rally that looks very extended, both in terms of duration and degree. There is also a powerful case that EM currencies can perform well driven by extremely cheap valuations, relatively high real rates and strong current accounts. Outside of currency, there are two key positive factors which we believe should support EM performance over the medium term. Firstly, both earnings and relative EM growth look set to improve from cyclically low levels, driven by improved productivity, structural reforms and more growth-friendly fiscal policies. Secondly, the valuation case for EM remains strong, particularly relative to developed markets ("DM"), following the significant underperformance of recent years.

"We have observed that country and sector divergences in EM have been high in recent years."

Despite the relatively disappointing index performance over recent years, there have been clear winners and losers, and we believe the need for active management in this environment – including emphasising ESG factors and consideration of opportunities outside of the benchmark – is vital if investor returns are to be satisfactory.

In terms of style, we believe that both Quality and Value look attractive from a valuation standpoint and that a higher rate environment can support both factors. At the same time, we believe that there is a strong case for caution on Growth stocks which remain crowded and expensive, with deteriorating fundamental outlooks. We also believe that both higher dividend yielding stocks and EM smaller caps, which have tended to do well over longer periods but which have underperformed more recently, look attractive.

We have observed that country and sector divergences in EM have been high in recent years. We have been particularly positive on the outlook for India for several years, driven by long-term structural tailwinds, although strong performance in the last two years has left the market looking somewhat expensive. Korea, Brazil and Mexico all look attractive from a valuation standpoint and we believe that all three markets have particularly cheap currencies.

In terms of sector positioning, we favour domestic sectors driven by high returns and supportive tailwinds such as rising incomes, positive reform momentum, attractive demographics, rising urbanisation and positive employment trends. Within cyclicals, we have a preference for financials, based on valuation, improving asset quality, low penetration and structural growth.

[1] RBC GAM and Bloomberg.

Investor Q&A

Equity markets have faced a volatile time in 2022, particularly in EM. As we look towards 2023, Philippe Langham, Head of RBC Emerging Markets Equity, answers the questions that have been top of mind for our clients.

How should investors think about EM equities now, given their many years of underperformance relative to DM?

While EM equities have shown excellent long-term performance, relative performance in the last decade has been disappointing. We have found that relative performance occurs in waves and the factors that have held EM back in the last decade have a strong case to reverse. In particular, thereis a strong negative relationship between the USD and relative EM performance. Following over a decade of powerful performance, the USD looks extended and has not been this overvalued for 20 years. Money supply growth in the U.S. is at record levels and aggressive fiscal spending is leading to significant debt[2].

The valuation of EM compared to DM equities also looks compelling at a time when EM profitability is improving from relatively depressed levels.

The index is also becoming more attractive with less cyclical stocks and a growing weight in areas of structural growth, including consumer, technology and green infrastructure, with a much broader choice of high-quality franchises than has historically been the case.

EM represent 60% of global GDP[3] and account for the vast majority of global GDP growth, yet most investors have very little exposure to the asset class. Superior growth from EM should continue, driven by favourable demographics, the ability to catch up in technology and much lower penetration in a wide range of different areas. At a time when it is difficult to find attractive assets at reasonable valuation levels, there is a strong case for investing in EM.

Will the authorities in China allow capitalism to thrive?

In recent years government policy has reversed away from opening up and reform. At the same time, in our view, it is clear from the end of the National Congressthat, going forward, China will be run primarily aroundpolitics rather than economics.

While regulatory headwinds have always been an essential consideration when investing in EM stocks, in China, we have seen an acceleration in regulation in recent months, and this regulatory action has had a pronounced impact on the market. It is also clear that the Chinese government's priorities have shifted in recent years from an emphasis on economic growth to having a primary goal of more equality and social stability by reducing social, environmental, financial and national security risks. When it comes to economic growth, we do not believe that the government has abandoned it entirely but rather we expect to see a focus on quality rather than quantity. The measures we have seen more recently to loosen Covid-19 restrictions and gradually reopen the economy can be viewed in this light.

While the changes we have seen in recent years are concerning, we do not believe that China will abandon capitalism. It is well accepted amongst the Chinese leadership that enterprise and free markets are a positive. The authorities also clearly recognise the importance of the private sector which accounts for over 80% of job creation in China, as well as the need for the private sector to help upgrade the economy in critical areas such as semiconductors, automation and renewable energy. Therefore they recognise that it is key that the private sector can thrive. Foreign investment is another crucial consideration and there have been a number of recent announcements by mainland authorities indicating that they want to encourage continued foreign investment into Chinese equities, with the Hong Kong Stock Connect remaining an important conduit.

Going forward, we believe that it will be important to be cautious on areas that are vulnerable to negative government policies and to be positioned in areas that the government is likely to support, such as renewable energy, electric vehicles and independent technology. Companies that are truly innovative and that can compete on the global stage should fare well. This environment should ultimately favour high-quality companies, with strong management teams and clear competitive advantages. We continue to view weakness in China as an opportunity to gain exposure to high-quality names positioned in areas of government support.

[2] CNN Business.
[3] McKinsey & Company.

What are your thoughts on investment style looking ahead?

We have seen a rotation out of Growth and into Value in the last two years, following a long period of strong performance from Growth. Despite Growth's recent underperformance, our view is that Growth as a factor still looks expensive and that the fundamentals of many Growth-type companies are not as strong as was perceived in the Covid period, when their performance soared. Value as a factor, despite its recent rebound, still looks attractively valued and is also a factor that tends to do well in any market rebound. Quality had been out of favour in recent years, until recently, but we believe it has an attractive outlook. It is a long-term outperforming factor that currently looks unusually cheap. We also believe that the macro environment of slowing growth and higher inflation should be supportive of Quality.

What is your outlook for the Chinese property market?

China's property market has been in a severe downturn since early 2021, following the government's aggressive efforts to contain excesses in the sector. Developers have been in a financial crunch and demand has been further suppressed by Covid lockdowns. The property outlook now largely depends on policy which has always been instrumental in driving cycles in China. While we have started to see supportive measures, we believe that concerns over moral hazard will prevent authorities from providing the level of support required to drive a significant rebound. A more relaxed stance, along with an easing of Covid restrictions, should ease strains in 2023, but looking further ahead, structural issues and previous excesses are seen as long-term overhangs.

What are your thoughts on Brazil, following the election?

Luiz Inácio Lula da Silva ("Lula") was elected president of Brazil in a very close second round, the tightest race in recent Brazilian democratic history. Now, the market's focus will likely turn to cabinet appointments and policy announcements from the newly-elected president.

On the policy front, Lula has been clear that he wants to eliminate the current fiscal spending cap legislation. The fiscal rule is expected to be changed from the current spending cap rule to an annual target for primary fiscal result.

Looking ahead, we have a constructive view on the Brazilian market for three reasons:

1. From a macroeconomic perspective, Brazil has some of the highest real rates among EM countries[4] following aggressive rate hikes by the central bank. Inflation in Brazil likely peaked in April and has since fallen back, which has allowed the central bank to pause interest rate rises. This could help Lula reap the economic benefits, from Brazil having been the first major economy to successfully move against inflation by using aggressive monetary policy.

2. We believe that political risk has diminished, following the very close election. It is probable that Lula's ability to introduce any extreme market-negative policies has been reduced, as institutional constraints should act as inhibitors. In comparison to Lula's first term as President, the legislature now has far more control over fiscal spending than the executive. Lula's party and its electoral allies are not close to commanding a majority in either the Senate or Chamber of Deputies.

3. Valuation levels look attractive on both a relative and absolute basis. We have always recognised that there are many great franchises in Brazil, with very strong management teams. We are able to find strong companies in Brazil within our domestic consumption and financialisation themes, in particular.

Despite these positives, Brazil has a number of structural issues that the new government will have to address over the longer term. One of the key challenges is the country's debt balance. Brazil has a Debt-to-GDP ratio of more than 70%[5], which is the highest across Latin America and will likely weigh on long-term growth. If we were to see important reforms come through, such as tax reform, that would make us more positive on Brazil over the longer term.

A structural positive for Brazil is that it is well positioned in terms of its natural resources. It is one of the world's largest commodity exporters and some of its key exports include soybeans, corn and iron ore. It is also a country with ample land and water reserves, which should bode well in terms of its ability to gain further share in global commodity markets going forward.

[4] MercoPress.
[5] www.tradingeconomics.com.

Following very strong performance in the last two years, is India still attractive?

The strong relative performance from India in the last 24 months, despite the negative headwind of monetary tightening, has left valuation levels looking relatively high. However, there continues to be several structural factors that make us positive on India:

1. **Property upturn:** we see compelling evidence of an upturn in the residential property market[6], following a seven-year downturn with a resulting positive multiplier impact,

2. **Growth:** penetration in a large number of areas is still relatively low and we believe that India offers the highest long-term growth potential in the EM universe,

3. **Reforms:** in recent years we have seen significant reforms implemented by Prime Minister Modi's government, including GST tax, demonetisation, FDI deregulation and labour reform,

4. **A new CapEx cycle:** after a multi-year hiatus, we are starting to see a huge improvement in the CapEx cycle (with a pickup in private industrial CapEx), the property cycle recovering after an eight-year downturn and government spending supporting further investment,

5. **Stocks:** the quality of corporates in India is very strong and corporate governance in the companies we tend to own is among the best in the universe.

When will China remove its zero-tolerance policy towards Covid?

China remains the one major country in the world where Covid containment is still an issue. Given that everywhere else in the world has opened up, it would seem to be a matter of time until China does so too. In terms of determining exactly when, we believe that there is still limited visibility, given the mixed signals from policy leaders. Recent pronouncements have been somewhat contradictory, arguing for the importance of containing Covid while also arguing for the importance of limiting economic damage.

There have also been statements reiterating continuity while more recent messages have focused on a relaxation of rules. Vaccine rates among the vulnerable remain low, and we have previously seen several false dawns. Putting this altogether, we believe that relaxation of Zero-Covid is coming but it will be gradual and unlikely to be fully in place until spring of next year, by which time the worst of any seasonal spikes will have occurred and vaccine levels should have improved.

How do you view the risk of tensions between Taiwan and China escalating to a full military conflict?

Assessing the risk of China invading Taiwan requires consideration of a number of factors. On one hand, there is the Chinese Communist Party's ("CCP") desire for a complete reunification, which the CCP refers to as a "historic mission". In contrast, Taiwan desires to remain independent. Two newer factors are: **1)** the U.S. administration's imposed export restrictions of semiconductors to China; **2)** Taiwan's strong position in the global semiconductor industry, which raises its strategic importance to both the U.S. and China.

Overall, our view is that while the risk of a full occupation of Taiwan may have marginally increased since last year, it still remains low.

There are two reasons why we believe that the risk remains low. Firstly, we believe that the Chinese population does not want a conflict. From a popularity perspective, President Xi has much more to lose than to gain, as a military invasion could become very costly both economically and in terms of human casualties. Russia's invasion of Ukraine serves as a good reminder of the latter. When taking into account that Russia and Ukraine share a land border, and considering the added complications that trying to take an island would cause, the situation would be difficult for China to successfully achieve without high casualties. This last point is of paramount importance given familial ties between the Taiwanese and Chinese populations, which mean that any level of casualties would be very poorly received within China and would possibly lead to uprisings. Secondly, China's current, primary long-term objective is to achieve economic supremacy, before any aspirations of geopolitical supremacy are considered. One of the pillars to reaching this objective is maintaining a non-hostile external environment, in order to avoid either isolation or any sanctions that could jeopardise the country's economic development plan.

[6] Times of India.

One key risk to the status quo, or to a peaceful reunification outcome achieved through gradual integration ("one country, two systems"), comes from the U.S.'s imposed tech export restrictions to China, which have recently escalated. The risk is that too many setbacks may push China to a radical response, such as occupation of Taiwan, a country which controls the overwhelming majority of global chips production. This is a relatively new development, and hence why we think the risk has marginally increased from last year.

To what extent are EM countries vulnerable, following much tighter conditions globally and the surge in food prices?

When analysing both the impact of tighter conditions and the impact of rising food prices we have found that there are a few countries that stand out as being in a relatively weak position. These countries are largely frontier markets or smaller EM, and the vast majority of the MSCI EM Index is comprised of countries in a stable position. We have seen a significant improvement in the balance sheets of most EM in recent years and countries such as India, South Africa, Brazil and Indonesia that were historically relatively weak now have much stronger current account and fiscal positions. They also look to be in a stronger position relative to many DM countries.

What are the key challenges and opportunities for EM overall, from the transition to a lower carbon world?

The global risks from climate change have become increasingly apparent and we believe these risks are particularly great for EM due to their geographic vulnerability to extreme weather events, issues such as water scarcity and their inability to finance solutions. At the same time, it has become clear too that incremental steps to tackle climate change will no longer suffice and drastic action by governments, corporates and individuals will be required globally.

As seen in the developed world, there have been a wide range of objectives, targets and policies that have been announced in a number of EM to help mitigate the impact of climate change. Given their size and current carbon footprint, there is considerable focus on China and India, with China setting a net-zero carbon goal by 2060 and India by 2070, and both have also announced shorter-term targets with an emphasis on large increases in non-carbon energy by 2030.

The next largest EM economy, Brazil, already has 80% of its energy coming from non-carbon sources, the majority coming from hydro power[7]. It is also becoming increasingly apparent that the transition to a lower-carbon world will most likely be very costly and will potentially imply higher consumer costs or bills, higher taxes on energy companies or individuals, and possible carbon tariffs. While most EM are importers of fossil fuels, there are potential long-term implications for countries, such as those in the Middle East that are exporters and are reliant on carbon.

What do you see as the biggest short-term risks to EM performance?

The two biggest risks we see are negative policy announcements from China and further USD strength.

Firstly, we have seen that the key feature of China's new Politburo Committee is that technocrats have been replaced by people who are clearly loyal to Xi. What is not clear is what this means in terms of policy direction and policy announcements. There is limited visibility on what the key priorities will be in China in both the short and medium term, and to what extent economic growth and deregulation will be supported.

Secondly, we have seen historically that there is an established inverse relationship between USD strength and EM performance[8]. This has been a key driver of the underperformance of EM equities relative to DM equities over much of the past decade. The long-term case for USD weakness following a decade of strength is sound, driven by a number of factors: valuation, U.S. policy which has led to surging money supply in the U.S. and large twin deficits, as well as much higher real rates in EM. However, in the short term, negative news on the inflation side could support expectations of further U.S. monetary tightening and could trigger continued USD strength, which would be a risk to EM performance.

[7] Climate Scorecard.
[8] Source: Bloomberg.

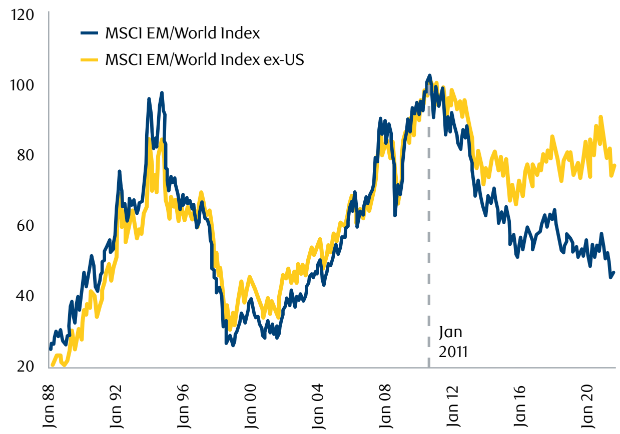
Earnings and valuations roundup

After significantly outperforming DM in the 2000s, EM equities have underperformed their DM counterparts since 2010 (Exhibit 1). Factors causing EM to lag DM over this time period have included ongoing USD strength and dwindling EM credit growth, coupled with increased levels of debt. In recent years, political uncertainty including shifts towards populism, increased regulation and higher levels of trade protectionism have weighed on returns for EM compared with broader DM. However, it is notable that the bulk of DM outperformance is attributable to the U.S., which has significantly outperformed its DM peers since January 2011, boosted until recently by the strong surge from its internet heavyweights (Exhibit 2).

Exhibit 1: Relative performance of MSCI EM Index versus DM

Source: Bloomberg, MSCI EM Index, MSCI World Index. Data as at November 2022.

Exhibit 2: MSCI EM Index versus DM and DM ex-U.S.



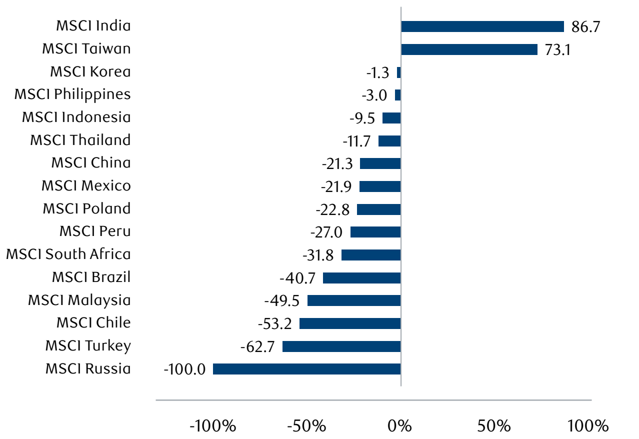
Source: CLSA Research, MSCI. Data as at November 2022.

2022 has been a difficult year for equity markets globally, with EM and DM equities both in negative absolute territory[9] thanks to tightening monetary policy, spiralling inflationary and recessionary concerns and supply chain worries, as well as energy worries triggered by the Russia-Ukraine conflict. USD strength has continued to prove an overhang for EM, but during the first three quarters of 2022, EM largely kept pace with DM, despite ongoing political and geopolitical uncertainty.

[9] MSCI EM Index and MSCI World Index.

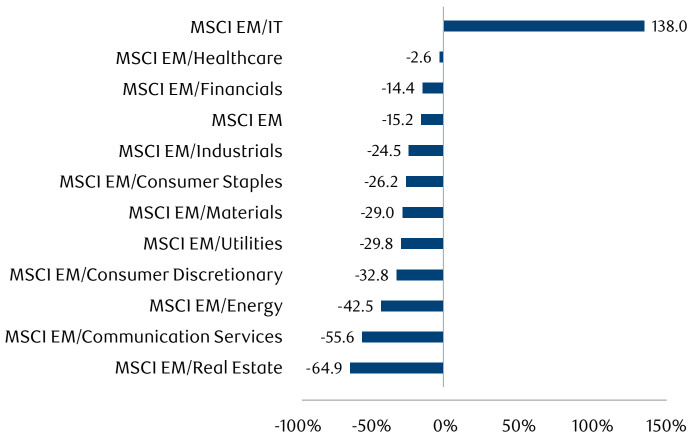
When looking at countries and sectors, there continues to be significant performance divergence within EM over both the short and long term. This year has seen the expulsion of Russia from EM benchmarks following the Ukraine invasion, and subsequent liquidity issues around trading Russian stocks, with stocks valued at zero. Even excluding Russia, however, 2022 data mirrors the longer-term picture in showing distinct variation in performance across geographies and industries. India and Taiwan have significantly outperformed over the last decade (Exhibit 3), and from a sectoral perspective, the IT sector, one of EM's weakest sectors in 2022, has been notably ahead of the pack on a longer-term basis (Exhibit 4).

Exhibit 3: MSCI EM Index country equity performance – 10 years



Source: RBC GAM, MSCI, Bloomberg. Data as at October 2022.

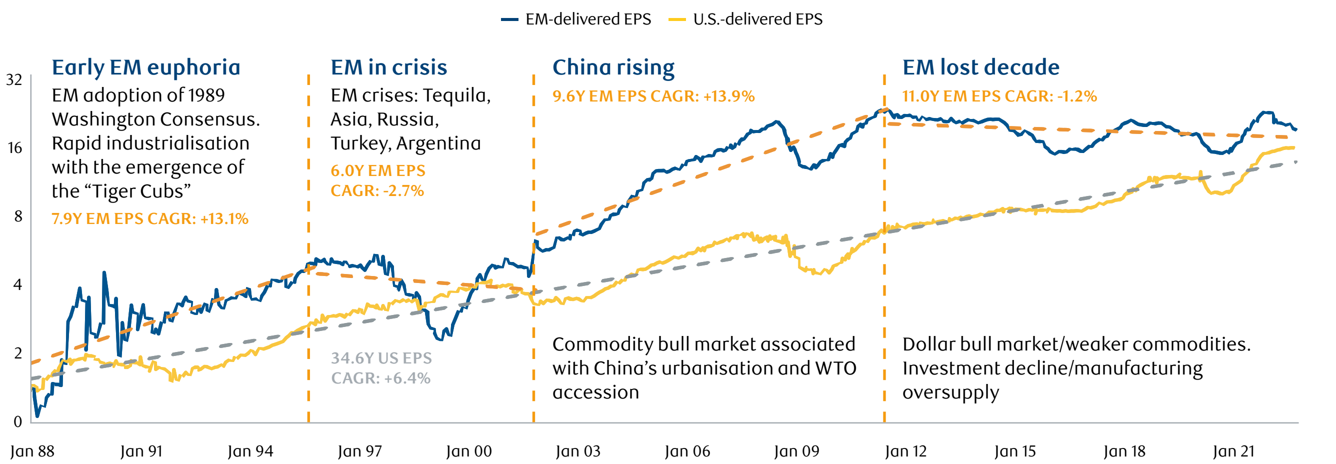
Exhibit 4: MSCI EM Index sector performance – 10 years



Source: RBC GAM, MSCI, Bloomberg. Data as at October 2022.

When thinking about performance in relation to earnings, the relative performance of EM equities compared to the U.S. market has tended to be driven by earnings supercycles. These are periods when structural long-term stories have underpinned longer-term relative EM earnings strength in USD terms. Examples include the industrialisation of Asia's Tiger Cub economies that bridged the late 1980s and early 1990s, and China's rapid development and rise in global prominence that triggered the commodity bull market spanning the bulk of the 2000s (Exhibit 5).

Exhibit 5: Supercycle phases for EM versus U.S. EPS



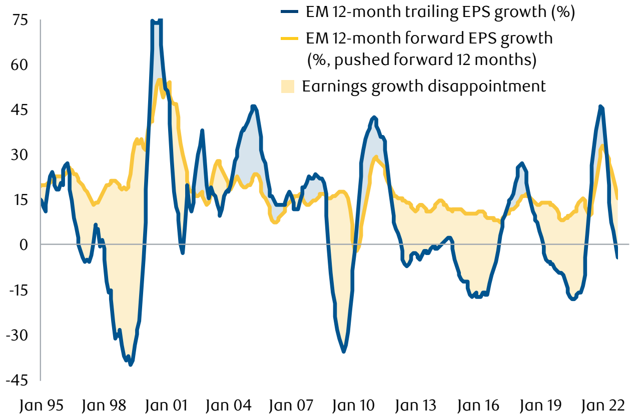
Source: CLSA, IBES, MSCI. Data as at October 2022, in USD terms, log scale. EPS = earnings per share; CAGR = compounded annual growth rate.

As Exhibit 5 shows, we have not seen these conditions in EM over the last decade. It could be argued, however, that we are currently experiencing an economic regime change, amidst a climate of higher inflation, elevated interest rates and increased commodity prices, with EM real rates potentially positioning the region well to weather the storm. Headwinds that have hampered EM in recent years, including the USD's bull run and China's pursuit of Zero-Covid policy, could feasibly abate, and there are multiple structural drivers within EM that could support a renewed period of EM earnings per share ("EPS") strength. If any of these were to occur in combination, it is reasonable that we could see a reversal of earnings trajectory and another EM earnings supercycle similar to those we have highlighted in recent decades, either across a shorter duration or something more long-term in nature.

EM earnings have underwhelmed compared with forecasts for the majority of the past decade, and we are currently experiencing another period of disappointment versus forecasts (Exhibit 6).

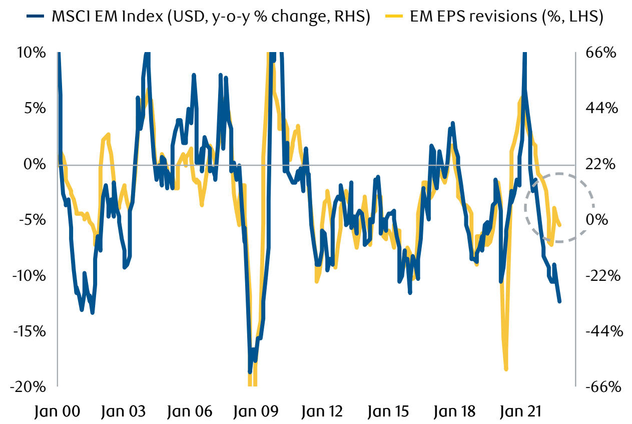
Exhibits 7 and 8 show earnings revisions versus performance momentum for EM and DM respectively. While EM has seen negative earnings revisions and performance momentum for the majority of the last eighteen months, it is worth noting that analysts appear to be further through the cycle of revising their optimism levels in EM (Exhibit 7) than in DM (Exhibit 8). Consensus numbers in the U.S. still point to earnings in 2023 being higher than in 2022, which in our view is optimistic given current macro conditions and the prospect of recession.

Exhibit 6: MSCI EM Index earnings growth: forecast versus delivered



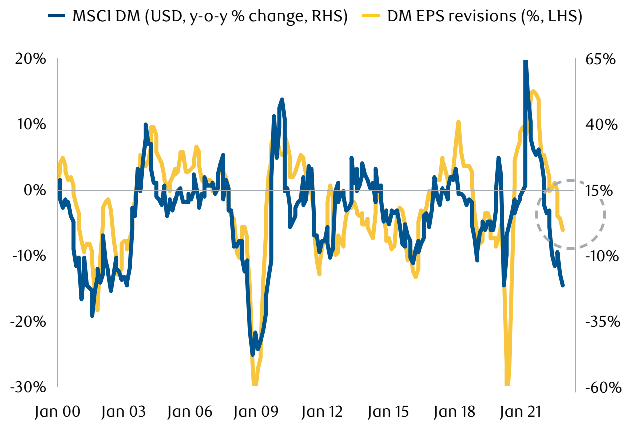
Source: CLSA, MSCI, IBES. Data as at October 2022.

Exhibit 7: MSCI EM Index earnings revisions versus performance momentum



Source: CLSA, MSCI, IBES. Data as at October 2022.

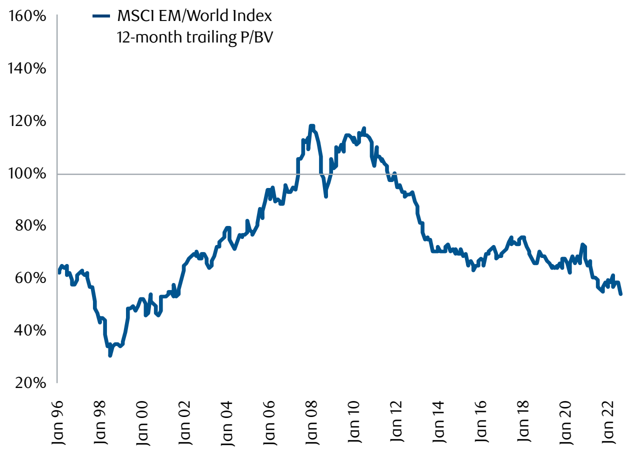
Exhibit 8: MSCI DM earnings revisions versus performance momentum



Source: CLSA, MSCI, IBES. Data as at October 2022.

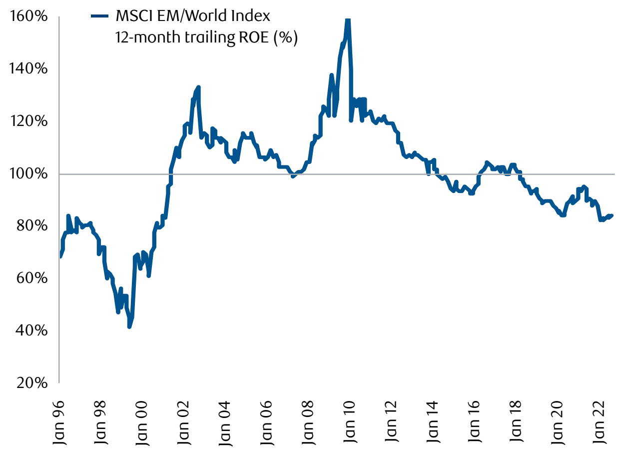
Looking at traditional valuation metrics, EM equity underperformance means that the asset class continues to look attractive compared to DM equities. From a price-to-book value ("P/BV") perspective, EM equities have been attractively valued on a relative basis since 2012, and the discount to DM currently stands at over 40% (Exhibit 9). EM returns on equity ("ROE") currently sit marginally below DM ROEs (Exhibit 10), but this is largely attributable to recent Chinese market softness; cost of equity is also higher within EM than DM. Historic data and structural drivers within EM markets, in addition to the significant uptick in quality of many EM corporates, lead us to believe that EM have strong future growth potential, and higher productivity could also buoy ROEs.

Exhibit 9: MSCI EM Index versus DM trailing P/BV



Source: CLSA, MSCI. Data as at October 2022.

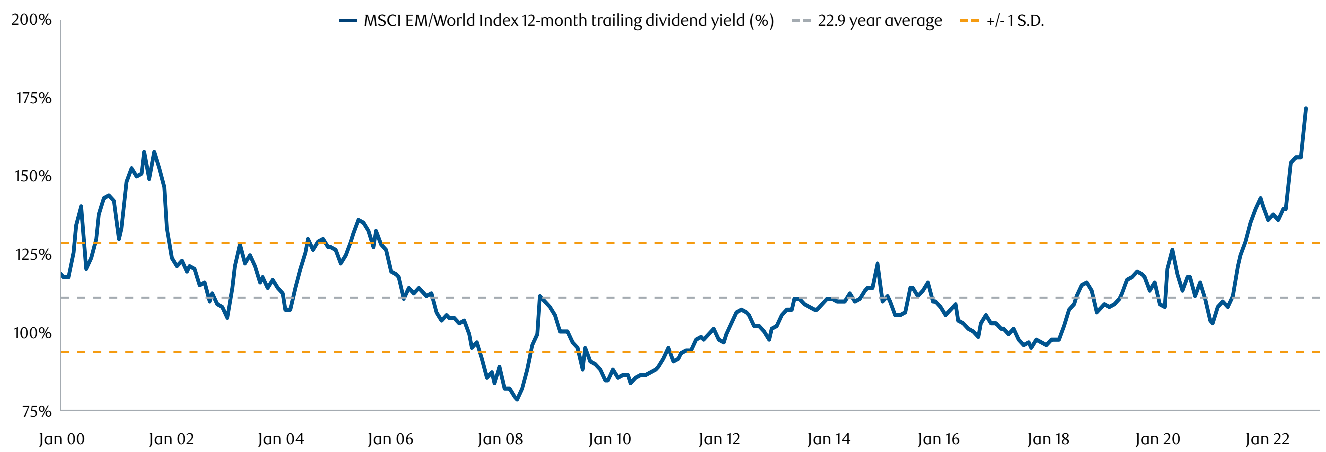
Exhibit 10: MSCI EM Index versus DM ROE



Source: CLSA, MSCI. Data as at October 2022.

In addition, EM dividend yields have continued their upward trajectory and remain markedly higher than DM dividend yields, reaching their highest relative point in the last 20 years (Exhibit 11), and now sitting at approximately two standard deviations above the long-term average.

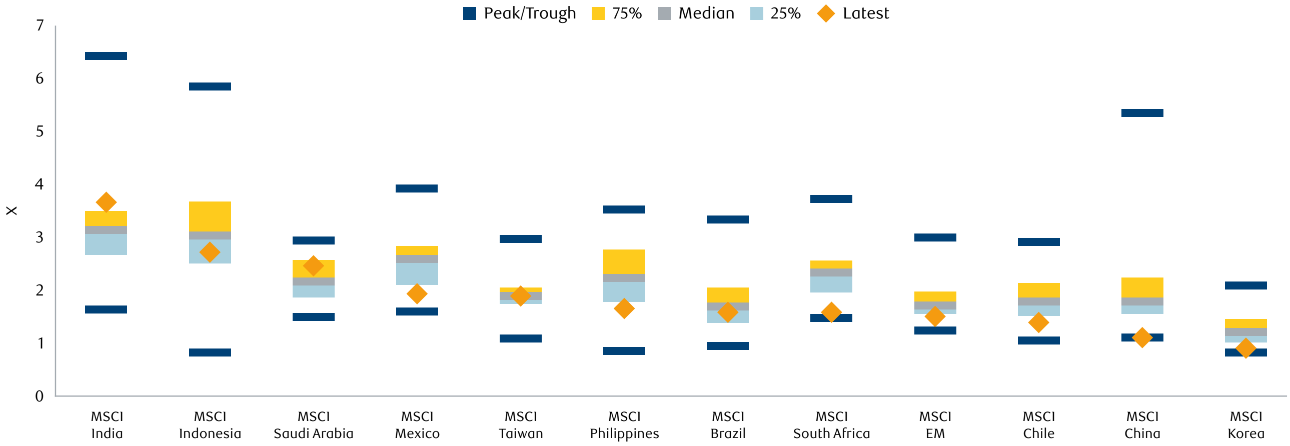
Exhibit 11: MSCI EM Index versus DM dividend yield



Source: CLSA, MSCI. Data as at October 2022.

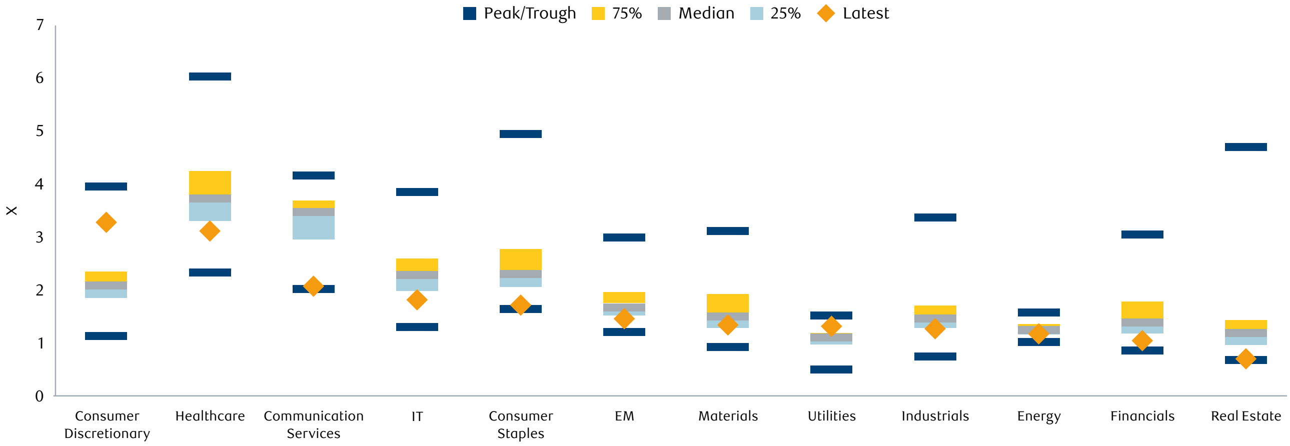
These factors contribute to the majority of EM countries and sectors looking cheaper on a P/BV basis than the averages since the turn of the century (Exhibits 12 and 13). While there are exceptions such as India, where we see high-quality companies but valuations continue to appear expensive compared with history, as well as the Consumer Discretionary sector, many EM countries and sectors are sitting in the cheapest quartile of valuation levels. Some areas, including China, Korea and the Communication Services and Real Estate sectors, are approaching historically cheap valuations, supportive in our view of the potential for EM to outperform.

Exhibit 12: MSCI EM Index countries – trailing P/BV since 2000



Source: MSCI, Datastream, UBS. Data as at October 2022.

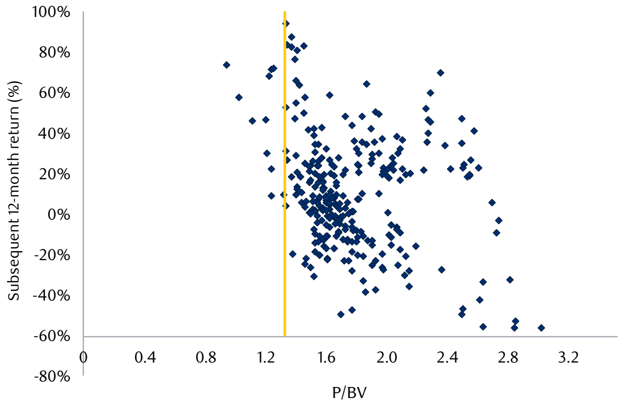
Exhibit 13: MSCI EM Index sectors – trailing P/BV since 2000



Source: MSCI, Datastream, UBS. Data as at October 2022.

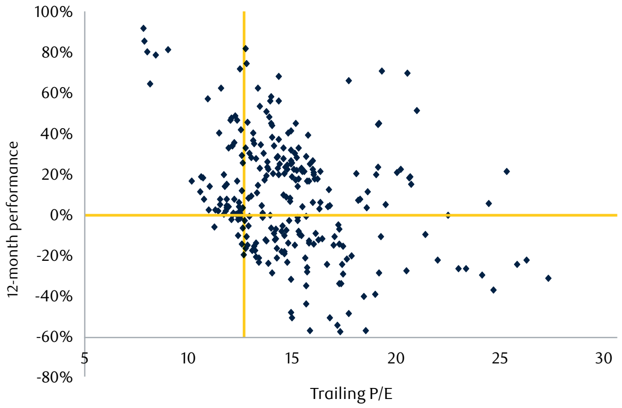
We outlined in last year's Outlook report that there tends for the most part to be low correlation between valuation and future performance, except at extremely high or low valuation levels on a P/BV basis (Exhibit 14). The thresholds we highlighted were below 1.35x on the cheaper end and above 2.5x on the more expensive end, and at these points we have historically seen strong buy and sell signals when viewed in the context of subsequent performance. The MSCI EM Index has now crossed this threshold to sit at a valuation level of 1.3x P/BV, which could signpost improved returns on the horizon. From a trailing price-to-earnings ("P/E") perspective, while there appears to be slightly lower correlation between valuation levels and subsequent returns than for P/BV, the trends are similar, and EM looks to be approaching levels of cheapness that have historically signalled positive returns in the following 12 months (Exhibit 15).

Exhibit 14: Historical MSCI EM Index P/BV versus subsequent 12-month return (since January 1996)



Source: RBC GAM, MSCI, Bloomberg. Data as at October 2022.

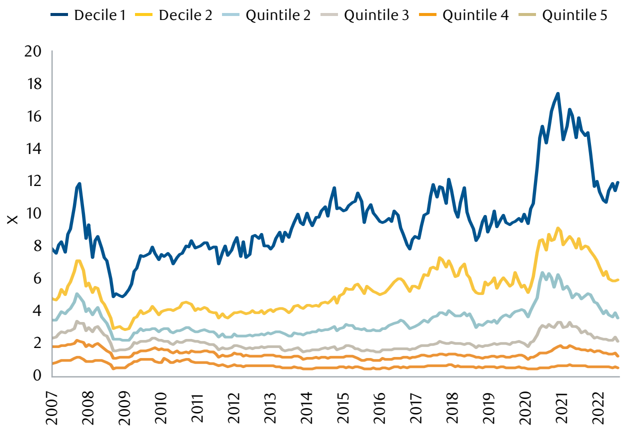
Exhibit 15: Historical MSCI EM Index P/E versus subsequent 12-month return (since January 1996)



Source: RBC GAM, MSCI, Bloomberg. Data as at October 2022.

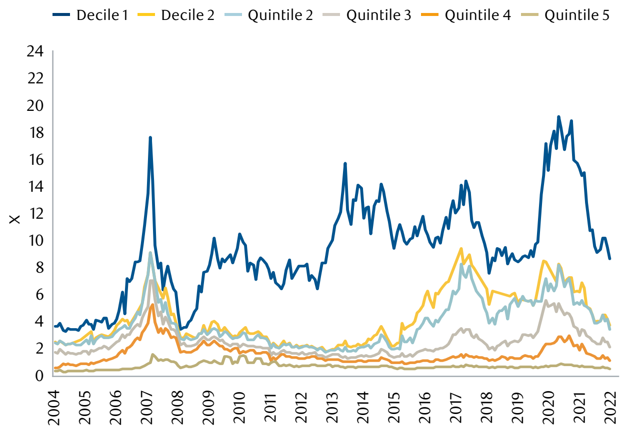
Exhibit 16 shows the MSCI EM universe broken down into P/BV fractiles, with the first quintile split into its two deciles. The graph shows that despite valuations in the top decile having come down from their Covid peaks, P/BVs in this portion of the market continue to look high. Much of the dip is attributable to China, as shown when splitting out Chinese equity P/BVs from the rest of the EM universe (Exhibits 17 and 18), with Chinese equities derating to return to pre-pandemic levels. That said, elevated valuations remain with the top quintile across the EM universe, and this quintile still looks expensive when viewed in the context of ROEs (Exhibit 19). With this in mind, we continue to believe it prudent to avoid being overly exposed to the most expensive and cheapest segments of the market, instead focusing on the middle quintiles where we can find quality franchises at attractive valuations.

Exhibit 16 – MSCI EM Index P/BV (x) per P/BV fractile



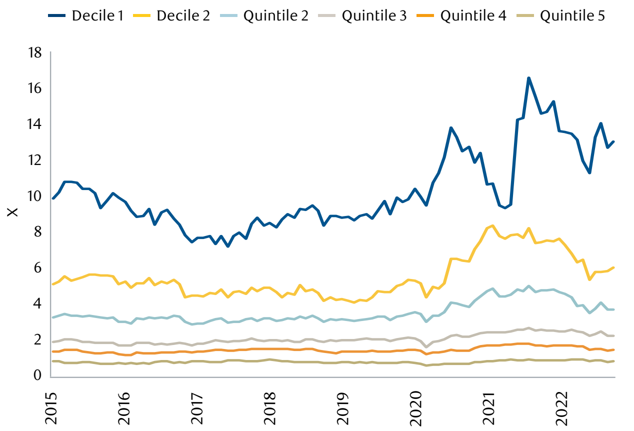
Source: RBC GAM, FactSet, MSCI. Data as at September 2022.

Exhibit 17 – MSCI China Index P/BV (x) per P/BV fractile



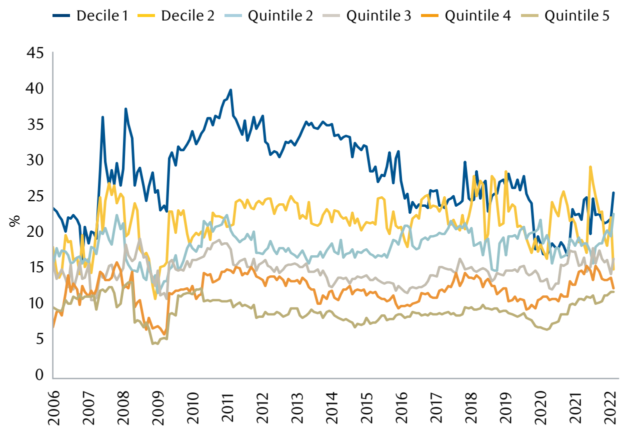
Source: RBC GAM, FactSet, MSCI. Data as at September 2022.

Exhibit 18 – MSCI EM Index ex-China P/BV (x) per P/BV fractile



Source: RBC GAM, FactSet, MSCI. Data as at September 2022.

Exhibit 19 – MSCI EM Index ROE (%) per P/BV fractile



Source: RBC GAM, FactSet, MSCI. Data as at September 2022.

In conclusion, we believe that EM equities currently look undervalued, especially relative to DM. If we are entering a new economic regime with higher inflation, higher interest rates and higher commodity prices, our belief is that EM, where real rates are low and inflation has been managed, could benefit and outperform DM, particularly if we see any weakening in the USD or a shift in Covid policy in China. We continue to avoid the most expensive and cheapest sections of the EM universe, and our aim remains to invest in high-quality businesses at attractive valuations that are sustainably run and are well positioned for long-term growth.

Emerging markets country outlook

- When assessing the relative outlook for individual EM countries in 2023, we look for extremes in terms of economic fundamentals, valuation, and returns.
- Our long-term country weights are driven by our bottom-up stock picking and long-term structural views. However, we use our outlook on individual countries to increase or decrease our weights at the margin.
- We have been defensive on China in 2022 due to the ongoing deleveraging policy and Zero-Covid policy. We are starting to turn slightly more positive due to its much improved valuation, and as we start to see the country gradually reopen. We remain underweight due to bottom-up corporate governance concerns but will look to add incrementally on further weakness.
- We are turning more cautious on India in 2023 despite our long-term positive structural view. This is due to its very high equity market valuation relative to expected returns, as well as the risk of a weaker rupee due to rising inflation and a historically high fiscal deficit.
- We expect the Taiwanese dollar to be relatively resilient. However, we do see a risk to equity markets if the global tech cycle continues to be negative in 2023, or U.S.-China tensions continue to rise.
- Korea, while also vulnerable to a negative tech cycle, looks more attractive than a year ago due to its equity and currency valuations. Both the equity market and won are trading at near all-time lows.
- Despite recent downgrades we are turning more positive on Mexico, Brazil, and South Africa given their relatively strong macroeconomic fundamentals and cheap currencies, combined with attractive equity market valuations.

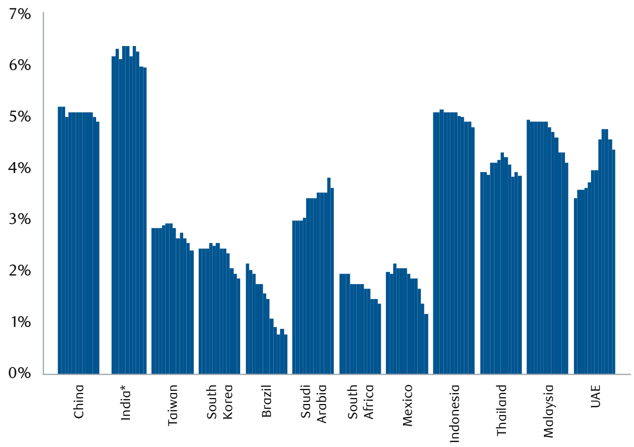
Economic forecasts

After a strong rebound in 2021 and 2022, consensus forecasts still expect robust growth for major EMs in 2023 (Exhibit 1), however more recently we have started to see downgrades in a number of countries, especially in Latin America as commodity prices have dropped and the USD has strengthened. Brazil, in particular, has had large recent downgrades, with consensus growth for next year being cut from 2.2% last year to 0.8% at the end of October. Similarly, Mexico has been downgraded from 2.0% to 1.2% over the same period. North Asia has been an area where forecasts have also been cut. Current consensus for China is for its economy to grow a solid 4.8% in 2023, however we have seen more dramatic cuts in growth expectations for Taiwan and South Korea in recent months, now expected to grow 2.5% and 1.9% respectively.

> **"When assessing the relative outlook for individual EM countries in 2023, we look for extremes in terms of economic fundamentals, valuation, and returns."**

On a positive note, expectations for India's growth remain very robust, only being slightly downgraded, and still expected to grow at over 6% in 2023. The EM countries that have had expectations upgrades in growth for next year have been oil exporters in the Middle East, with Saudi Arabia and the UAE both being upgraded due to the increase in oil and gas prices this year.

Exhibit 1: Last 12 months Bloomberg consensus 2023 GDP growth



Source: Bloomberg. Data as at 31 October 2022.
*India forecast is for the 12 months ending March 2024.

We flagged inflation as a risk in last year's Outlook report, and indeed inflation has been in the headlines over the last 12 months for all the wrong reasons. Although inflation has been rising globally, in EM inflation has historically been driven, at least in part, by increasing fiscal deficits relative to economic output. High and rising inflation has been a factor in the downgrades in real GDP growth expectations for next year.

Exhibit 2 shows that all of the largest 12 EM countries have experienced an increase in inflation expectations for next year. This increase has primarily been driven by energy and food, which make up a larger proportion of consumer price indices ("CPI") baskets in EM. Although still high and rising, inflation is expected to fall in 2023 across the board relative to 2022, as energy and soft commodity prices come off their highs.

Korea stands out as having rapidly rising inflation expectations this year, given the sudden weakness in the won in the second and third quarters of 2022.

China is the standout major EM with low and stable inflation expectations. This has been driven by relatively limited fiscal and monetary easing during Covid in 2020, coupled with its managed currency that actually strengthened against the USD until March of 2022, before starting to weaken again in the second and third quarters. More recently, China's continued implementation of its Zero-Covid policy has reduced consumption, which has reduced inflationary pressures.

Given the historical relationship between fiscal deficits and inflation, it is useful to look at forward fiscal and current accounts balances to assess inflationary risks, currencies and thus growth. Although the deficits shown in Exhibit 3 are lower across the board than their 2020 highs, when governments everywhere experienced losses in tax revenue and had to increase fiscal support during the pandemic, they are still high by historical standards for some countries. In particular, the major EM countries that stand out are Brazil, India and South Africa, and this is especially a risk in a strong USD environment.

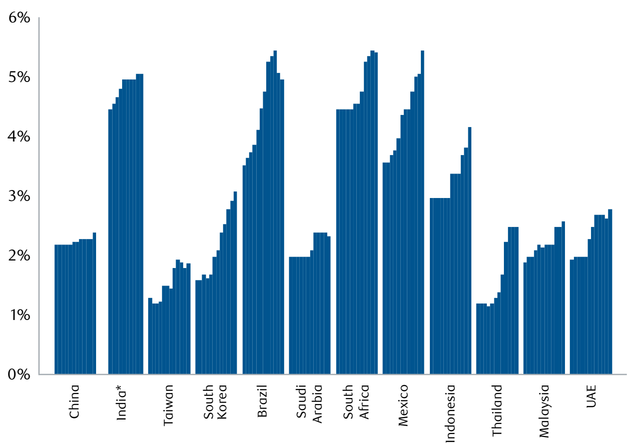
Current account deficits and relative spreads (or carry) are also important in assessing the macro risk of a country, especially to its currency and thus inflation.

"Although inflation has been rising globally, in EM inflation has historically been driven, at least in part, by increasing fiscal deficits relative to economic output."

EM currencies in 2022 have outperformed DM currencies by a significant margin, being very resilient in a strong USD environment. The key reason for this has been lower fiscal deficits (Exhibit 3) and very high real rates and carry relative to US treasury yields, as compared to DM countries.

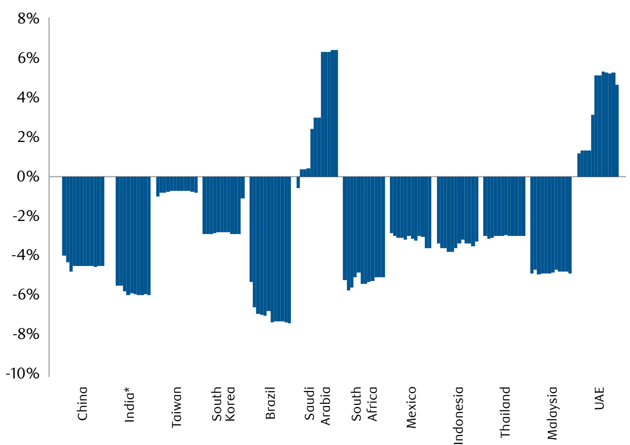
Latin America, in particular, looks resilient on this measure. Brazil, Mexico and Chile all have positive real rates and high carry relative to two-year US treasuries. India, South Africa and Indonesia also look robust on this measure.

Exhibit 2: Bloomberg consensus 2023 CPI 12 months revisions



Source: Bloomberg. Data as at 31 October 2022.
*India forecast is for the 12 months ending March 2024.

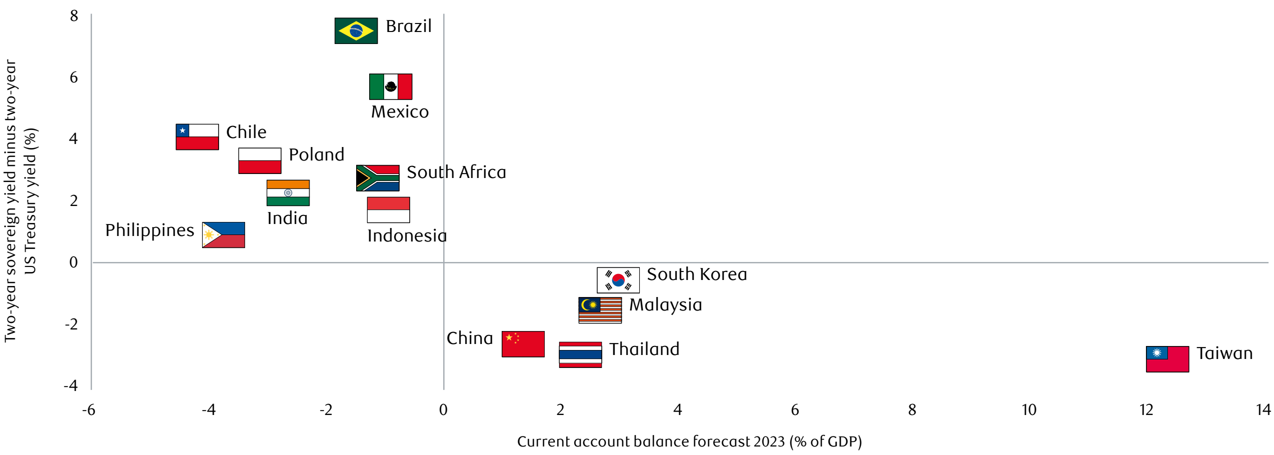
Exhibit 3: Bloomberg consensus 2023 fiscal deficit 12 months revisions



Source: Bloomberg. Data as at 31 October 2022.
*India forecast is for the 12 months ending March 2024.

North Asia and Thailand tend to have negative carry but positive real rates and positive current account balances (Exhibit 4), although one could argue that China and Thailand are the most vulnerable to higher US rates and/or inflation next year.

Exhibit 4: EM countries forecast current account balance versus two-year sovereign spread

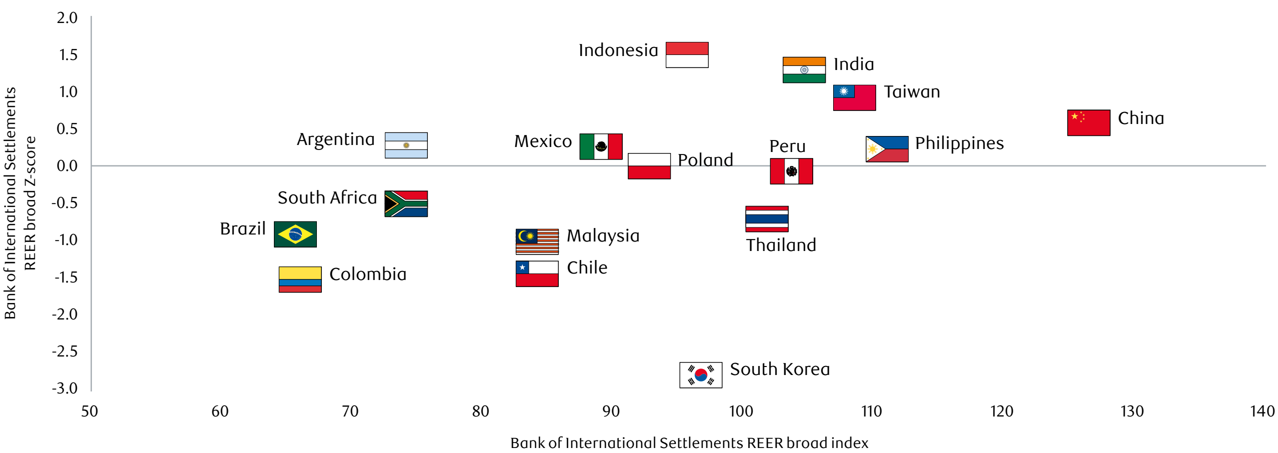


Source: Bloomberg. Data as at 7 November 2022.

Currency valuation

Exhibit 5 shows currency Real Effective Exchange Rates ("REERs") relative to one another on the X-axis, with the Z-score (the number of standard deviations away from the 10-year average) on the Y-axis.

Exhibit 5: EM currencies' REERs versus 10-year Z-score



Source: Bank of International Settlements. Data as at 31 October 2022.

In general, current EM FX valuations on this measure are not as cheap as they were in 2021. This is because the increased inflation rate over the last 12 months was offset somewhat by higher yields. There are notable exemptions to this, in particular the Korean won now looks very cheap on this measure, at 2.8 standard deviations below its 10-year average and now below 100. The South African rand and Taiwanese dollar valuations have also fallen over this period.

Despite its weakness in the second and third quarters of 2022, the Chinese renminbi still looks relatively expensive. This can be attributed to the People's Bank of China's marginal monetary easing, cutting a number of benchmark rates throughout the year, given its low inflation and sharp economic slowdown. China's external position and negative carry means that we would expect the continued depreciation of its currency.

In contrast to the Korean won, the Taiwanese dollar still looks rich on a REER basis, however its forward current account surplus of 12.3% justifies this valuation, unless there is a significant drop in exports which are dominated by the technology sector.

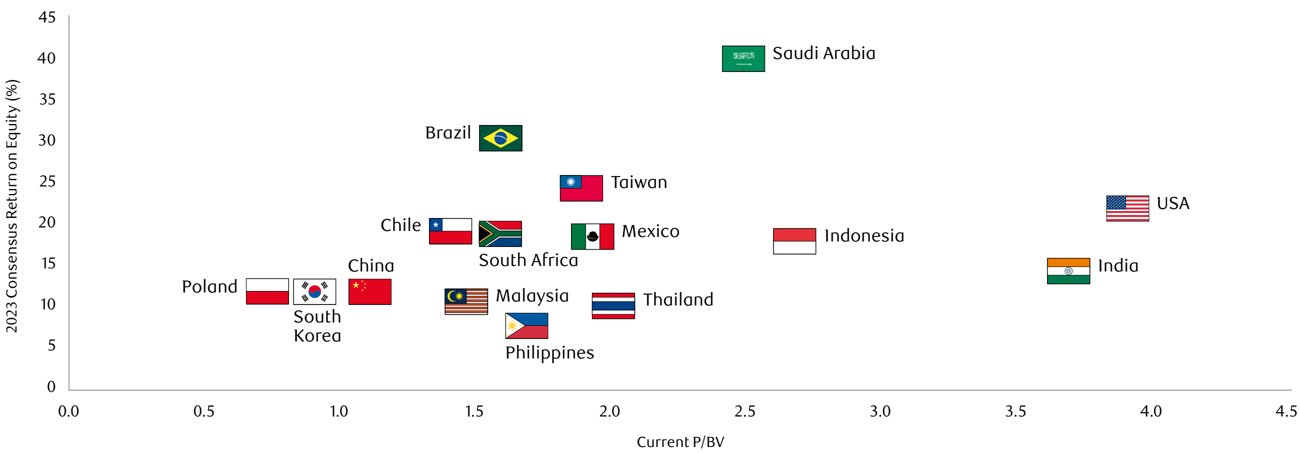
The Indian rupee, like last year, still looks overvalued despite having a lower current account deficit relative to history. The rupee's resilience over the last 12 months can be attributed to very strong economic growth and inflation that has remained anchored. However, given its relative low real rates and carry, if food and energy prices start rising again, this could put pressure on its currency in 2023.

Of the other major EM, the Brazilian real, South African rand, Chilean peso and Malaysian ringgit look attractively valued, especially given their robust economic fundamentals outlined above. The Brazilian real looks particularly resilient on a combined basis.

Valuation and returns

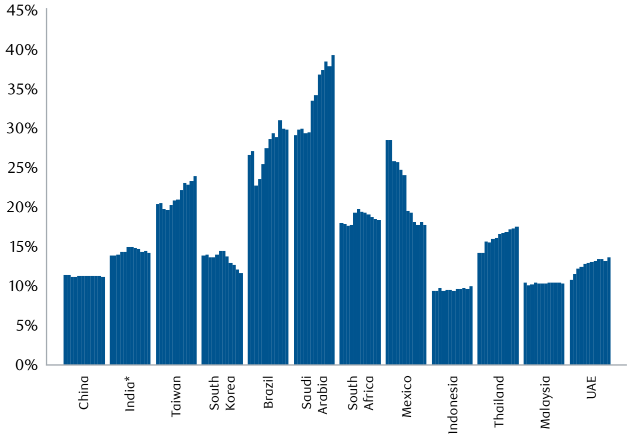
In terms of equity market valuations, we prefer to look at the consensus ROE as compared to the current P/BV of each country. This tends to be a more stable measure of valuation over time. Exhibit 6 shows the Bloomberg consensus ROE for 2023 versus the current P/BV for individual EM countries.

Exhibit 6: Current P/BV versus consensus 2023 ROE by EM country



Source: Bloomberg consensus. Data as at 1 November 2022.

Exhibit 7: Last 12 months Bloomberg consensus 2023 ROE



Source: Bloomberg. Data as at 1 November 2022.
*India forecast is for the 12 months ending March 2024.

Exhibit 7 shows consensus ROEs in 2023 by country. China has continued to underperform significantly in 2022. This is largely the result of continued concerns around the debt sustainability of the property industry, given the ongoing forced deleveraging of property developers. The continued enforcement of Zero-Covid has also dragged on economic activity, especially consumption. China is now trading on 1.1x P/BV, the lowest valuation in over 20 years for a consensus ROE of 11.1% in 2023. This extremely low valuation reflects increasing concerns around the continued implementation of the Zero-Covid policy, the risk of the property crisis becoming worse and rising geopolitical tensions with the U.S. over Taiwan and semiconductors.

> **"Other EM equity markets that look attractively valued relative to their prospective returns are Brazil, South Africa, Mexico and Chile."**

We remain cautious on India on these measures, given our view of the risk to inflation and the rupee. After very strong performance in 2021 and resilient performance in 2022, the MSCI India Index looks expensive. The current P/BV is over 3.7x, for a consensus ROE in 2023 of 14%. We like India in the long term due to the government's pro-market reforms, the country's favourable demographics and the large number of high-quality companies. That said, we do feel it is still overvalued in some places despite the most speculative parts of the market cooling off in the last 12 months. We would flag the risk of a correction in 2023 if the current high growth forecasts do not materialise, or if the Reserve Bank of India is forced to tighten more than expected, to defend the currency.

Taiwan has de-rated significantly over the last 12 months and is now trading at an attractive multiple relative to a forward ROE of over 23%. This discount to history also reflects the fact that it is the epicentre of rising geopolitical tensions between the U.S. and China. Taiwan does have strong macro fundamentals and a resilient currency, but as we highlighted last year, the country could be vulnerable to a continued slowdown in global tech hardware after two years of very strong demand.

Other EM equity markets that look attractively valued relative to their prospective returns are Brazil, South Africa, Mexico and Chile. All of these countries, as highlighted above, have relatively robust macro fundamentals relative to other EM.

Finally, after very weak performance in 2022, South Korea now looks very attractive from an equity perspective. The market is now trading on a P/BV of 0.9x combined with a forecast ROE of 11.5%. This reflects the rise in the risk of a global recession next year, given its sensitivity to global trade.

Geopolitical Risks

There are two main geopolitical risks in EM that investors should be aware of in 2023. The most obvious is the continued deterioration of U.S.-China relations, particularly around the question of Taiwan and semiconductors. The second, less obvious one, is the rising risk of social unrest in some EM countries due to food and energy scarcity.

U.S.-China tensions

Recently tensions have increased as the rhetoric from both sides has escalated. The speaker of the U.S. House of Representatives, Nancy Pelosi, visited Taiwan in August and met with Taiwanese President, Tsai Ing-wen, which provoked anger from Chinese authorities who continue to view self-governed Taiwan as a breakaway province. The military drills carried out off the Taiwanese coast in response marked a significant flare-up in the already fraught relationship between China & Taiwan, as well as exacerbating U.S.-China tensions.

The first thing we would say is that China is not Russia. China is much more integrated into the world economy than Russia was, and we have already seen the boomerang effect of sanctions on Europe's energy market. China's pursuit of increased integration since it joined the WTO in 2001 means that China is now the U.S.'s largest trading partner and vice versa (Exhibit 8). It would therefore be a serious risk to both countries if the U.S. and/or Europe were to impose sanctions on China similar to those which were implemented against Russia. Additionally, China and the U.S. both rely heavily on Taiwan's tech supply chains. We don't think either party would want the situation to escalate in a way that resulted in a sudden loss of access to the supply of semiconductors. The decoupling of China and the U.S. will likely continue in the longer term, but both parties know that sudden isolation would impose significant costs on both sides.

"The first thing we would say is that China is not Russia."

When it comes to China, our belief is that the country's primary long-term objective is currently to achieve economic development and self-sufficiency, before any aspirations of regional supremacy are implemented. Instead, China's focus seems to be achieving a much higher degree of self-sufficiency in certain critical areas, for example technology (especially semiconductors), and maintaining the current domestic agenda in pursuit of further economic development. This also involves maintaining a non-hostile external environment, in order to avoid either isolation or any sanctions that could jeopardise the transfer of knowledge and the country's economic development plan.

It is important to remember that neither China nor Taiwan actually wants a conflict. In Taiwan, approximately 95% of the population wants to keep the status quo, and only a combined 5% want either immediate independence or immediate reunification. As the Taiwanese population is happy with things as they are, there is nothing pushing the Taiwanese government to take a more provocative stance. The same is true in China; despite President Xi's rhetoric, there is limited pressure for him to take any military action, as the vast majority of the population believes that the ruling party's policies towards Taiwan are "tough enough and appropriate". As a result, from a popularity perspective, Xi has much more to lose than gain, as a military invasion could easily go wrong and become very costly, which would in turn cause his popularity to fall.

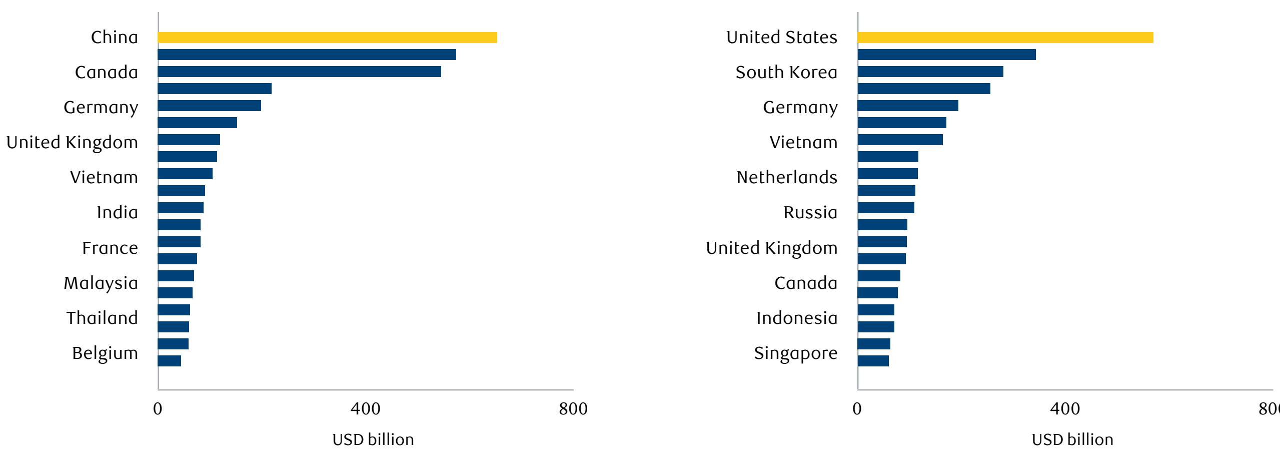
At the National Congress in October, Xi said, "with greatest sincerity, China will continue to try its best to achieve peaceful reunification". Again, he emphasised that the "Taiwan issue is China's own problem to solve" and that China won't allow "foreign interference". This is a reiteration of the status quo and didn't signal a change in policy towards Taiwan, despite Nany Pelosi's visit or the recent U.S. announcement of further semiconductor export restrictions to China, which impacts trade with Taiwan.

Based on the points above, our longer-term base case is either that the current status quo will be maintained, or that we will see a move towards a political solution (potentially a "one country, two systems plus" model). The key short-term risk is that of a miscalculation at sea or in the air, which if it were to happen, could still result in a military conflict.

Exhibit 8: The U.S. and China's trading relationship

U.S. – largest trading partners in 2020

China – largest trading partners in 2020



Source: Refinitiv, RBC GAM. Data as at March 2022.

Global food crisis

Even before the Russia-Ukraine conflict, many lower income nations were under pressure. The hit to growth from Covid, rising funding costs and reduced supranational support have left 41 low-income nations either in, or on the verge of, debt distress, according to the IMF. Meanwhile Sri Lanka has defaulted on its offshore debt and is experiencing anti-government protests, and in April of this year the Egyptian government asked the IMF for new funding assistance. Against this backdrop, soaring food prices could hardly have come at a worse time.

Many low-income nations are heavily dependent on imports for their wheat consumption, and with wheat providing approximately 20% of the world's calories, disruptions to supply can have catastrophic consequences. Together Russia and Ukraine account for around one-third of total wheat exports – 55 million tons each year – a contribution which has been severely disrupted with the ongoing conflict.

This disruption is leaving major wheat importers, among them Egypt, Turkey, Indonesia, Nigeria and Morocco, and many smaller import-dependent nations, scrambling to secure more costly supplies at a time when budgets are already under pressure.

To see which countries in our universe are most at risk from social unrest, we have tried to gauge their vulnerability to food shortages in the table of estimates below. Using the UN's Food and Agricultural Organisation database, we have estimated each country's net imports per capita of cereal and cereal preparations (semi-processed cereals such as wheat or rice flour) and compared this against GDP per capita to obtain a "Food Vulnerability Score" (Exhibit 9). While admittedly a rough approximation that won't cover exports of finished goods or current inventories, we still think it is a useful indication of where political pressure will likely be most acute next year.

Exhibit 9: Net imports of cereals and cereal preparations

Country	Net imports/capita (kg)	Nominal GDP/capita (USD)	Food Vulnerability Score
Egypt	158.9	4,162	38.2
Peru	195.2	7,034	27.7
Colombia	169.1	6,807	24.8
Vietnam	97.5	4,122	23.7
Philippines	82.4	3,687	22.3
Bangladesh	47.8	2,362	20.3
Sri Lanka	63.8	3,699	17.2
Mexico	158.6	10,166	15.6
Malaysia	199.2	13,268	15.0
Chile	213.3	15,941	13.4
Saudi Arabia	315.0	28,759	11.0
Turkey	84.6	8,081	10.5
Korea	311.5	34,994	8.9
Indonesia	41.6	4,691	8.9
Taiwan	253.5	36,051	7.0
United Arab Emirates	341.1	50,349	6.8
Qatar	257.6	84,514	3.0
China	28.2	14,096	2.0
South Africa	-0.8	6,979	-0.1
Thailand	-2.0	7,449	-0.3
Pakistan	-7.2	1,562	-4.6
India	-12.8	2,515	-5.1
Poland	-207.3	18,506	-11.2
Brazil	-121.6	8,570	-14.2
Hungary	-796.8	20,336	-39.2

Source: UN Food and Agricultural Organisation, UN Population Estimates, IMF, RBC GAM. Data as at 16 May 2022.

Unless we see an end to the Russia-Ukraine conflict, and the lifting of sanctions soon, energy and fertilizer prices will stay elevated. This will result in food shortages next year as farmers cut back on fertilizer use and choose to leave economically-marginal fields fallow. As such, investors need to be on the lookout for political unrest in the most vulnerable EM highlighted above.

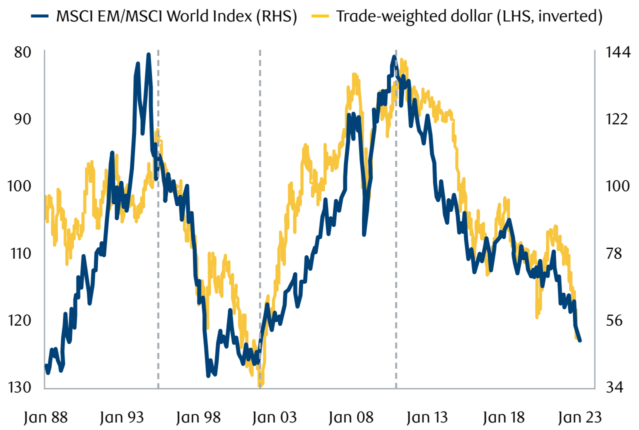
Global macro perspective

EM currencies versus the USD

There is an inverse relationship between the strength of the USD and the performance of EM equities, which exists on account of the USD inverse link with commodity prices, the relative costs of servicing EM USD-denominated debt and the flow of funds.

> "There is an inverse relationship between the strength of the USD and the performance of EM equities."

Exhibit 1: Trade-weighted USD versus MSCI EM Index/DM relative performance



Source: CLSA, Federal Reserve, BIS, MSCI.
Data from January 1988 to October 2022.

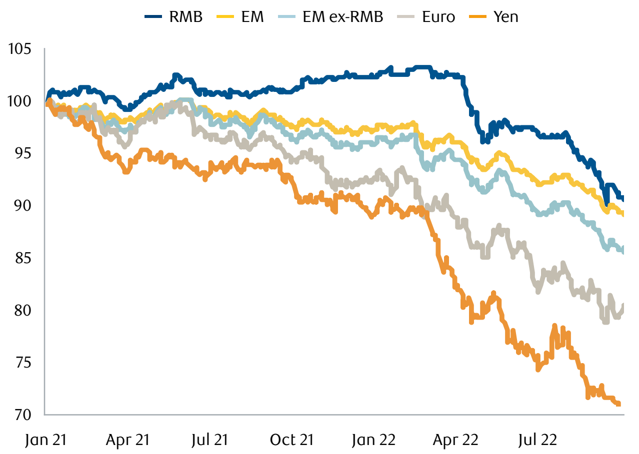
Clearly then, a weaker USD would be positive for EM equities.

What we have seen, however, is a structural USD bull market of over a decade, with the USD at a twenty-year high (Exhibit 1). This has contributed to the underperformance of EM equities and their currencies. However, we believe the preconditions for a USD correction are beginning to form and that as we get the bulk of the Fed hikes behind us, the pressure of the stronger USD should ease.

The last twelve months has seen some unusual occurrences. Firstly, DM currencies have weakened much more than EM – and even EM ex-China – currencies. As can be seen from Exhibit 2, the euro and yen have performed much more poorly than the EM currency basket. Secondly, previous Fed rate hiking episodes resulted in the USD correcting six to nine months later. This Fed rate cycle which started in March 2022 has been an exception, and one in which the USD has continued to strengthen and has yet to follow that weakening pattern (Exhibit 3).

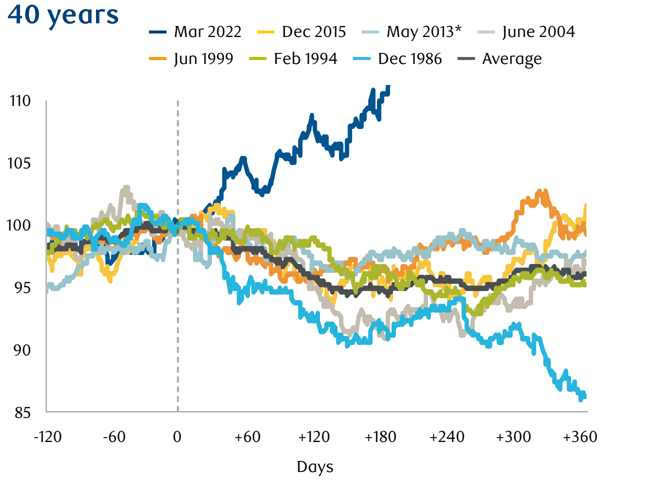
This anomaly can be explained by a very uncoordinated global monetary response, with the Fed raising rates a long time before the European Central Bank, and the Bank of Japan still adopting its quantitative easing strategy.

Exhibit 2: Currencies versus USD (nominal, rebased)



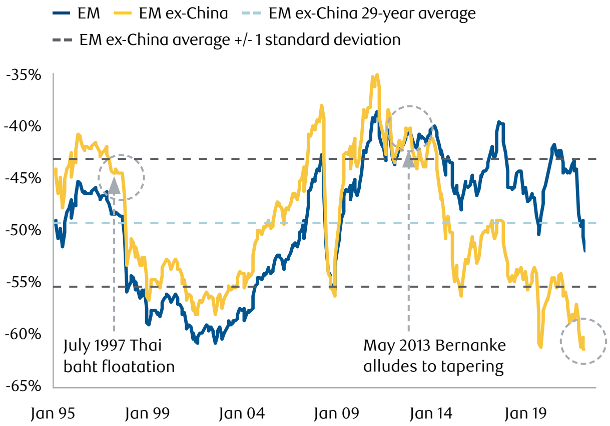
Source: CLSA, Refinitiv.
Data from January 2021 to October 2022.

Exhibit 3: Trade-weighted USD performance rebased to 100 at Fed lift offs over the past 40 years



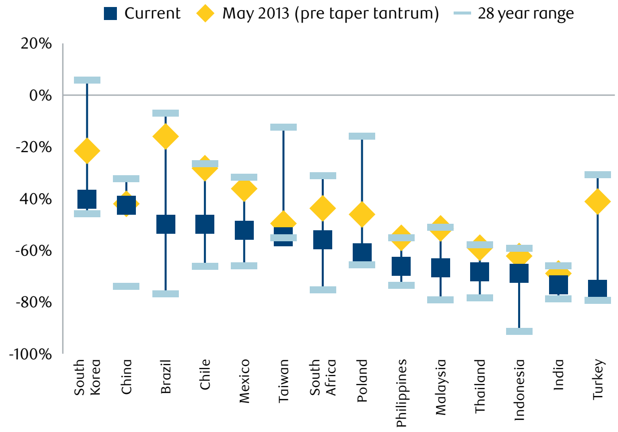
Source: CLSA, BIS, Federal Reserve.
*May 2013 refers to the Fed QE taper announcement.

Exhibit 4: EM aggregate deviation from PPP (GDP-weighted average)



Source: CLSA, Oxford Economics, Refinitiv.
Data from February 1994 to October 2022.

Exhibit 5: EM deviation from PPP versus history



Source: CLSA, Oxford Economics, Refinitiv. Data as at May 2013 and September 2022, with 28 year range.

However, we believe the economic pre-conditions for a period of USD weakness are now forming for a number of reasons. The US current account deficit has been at a record negative spread of 4.4% of GDP versus a Eurozone surplus, and this deficit is only modestly eroding. This level of relative external imbalance for the U.S. versus the Eurozone typically precipitates a USD bear market.

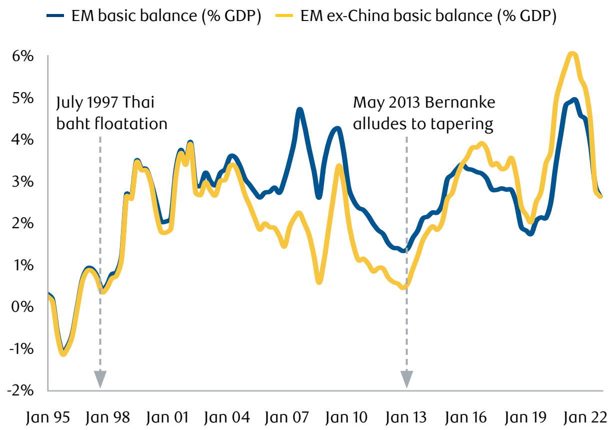
From a valuation standpoint, the USD also looks vulnerable, particularly versus EM currencies. Exhibit 4 shows that the GDP-weighted negative deviation from purchasing power parity ("PPP") for EM (excluding China) is close to a three-decade low at 60%, or almost two standard deviations below average. With the exception of China, all emerging currencies are below their respective PPP discounts recorded in May 2013, when the then Fed Chairman, Ben Bernanke, announced the tapering of Fed bond purchases (Exhibit 5). When looking at EM FX, it is clear that EM economies are in much better shape than they have been historically.

As can be seen from Exhibit 6, EM's global export market share has increased rapidly over the last year and is now over 35%. However, the currencies are yet to reflect that, as EM's (ex-China) REER appears to be lagging the region's gain in global exports share. Meanwhile, the market cap-weighted basic balance for EM at 3% of GDP surplus is far stronger in this tightening cycle than when Bernanke was tapering in May 2013, when it was close to 0%. (Exhibit 7).

Exhibit 6: EM (ex-China) REER versus global export market share

Source: CLSA, BIS, IMF, Direction of Trade Statistics.
Data from February 1995 to July 2022.

Exhibit 7: EM external position (market cap weighted)



Source: CLSA, Oxford Economics, Refinitiv.
Data from December 1994 to December 2022.

Style analysis

Looking back to this time last year, we expected the Growth style to continue to perform poorly, while Quality and Value stocks were expected to outperform, continuing the trend from 2021. The main reasons were: Growth stocks still being too expensive compared to their fundamentals, high inflation leading to higher interest rate expectations which would favour Financials (a large component of the Value universe), as well as a general rotation towards cyclicals as economies continued to reopen. Market movements proved us right, however we didn't anticipate that Russia would invade Ukraine, leading to a European energy crisis with global repercussions, namely a surge in inflation which pushed central banks to accelerate rate rises. We also warned that in the case of sticky inflation, rising interest rates globally would increase the likelihood of a recession which could potentially favour the Growth style. However, although those fears materialised, the forecast of larger-than-expected rate rises, as well as a surprising return to pre-Covid offline habits, led to a derating of longer-duration Growth stocks, especially the non-profitable ones in the new economy sectors.

"We believe that Value names are still too cheap and Growth stocks still too expensive compared to their fundamentals, and the very large Value underperformance of 2019 and 2020 has barely been closed."

So far in 2022, Growth has been the worst performing style in EM, while Value and Quality have outperformed the overall market. Small cap stocks have outperformed in a similar fashion to 2021, but to a much smaller extent.

Looking ahead to 2023, we expect to see this trend continue, with the positive relative performance of Value stocks and negative relative returns for Growth stocks. We believe that Value names are still too cheap and Growth stocks still too expensive compared to their fundamentals, and the very large Value underperformance of 2019 and 2020 has barely been closed. The beginning of the year could see Growth stocks outperform as the extent and length of a potential global recession is assessed. However, once some clarity is established, we expect a rebound in cheaper and riskier names, similar to that which we saw at the end of 2020. We don't expect any strength in Growth names to be sustained, given that the style's outperformance in the years up to 2021 came almost exclusively from new economy Chinese stocks, and the current political environment may not be conducive to a similar move in those names.

Furthermore, many of those names, notably exposed to the digitalisation theme, exhibit poor short-term growth, due to a high base and a decline in demand post Covid. Quality stocks are mispriced in our view, despite an environment which should have favoured them; we believe this anomaly will correct itself in the short term, as in particular, median Quality stocks trade in line with poor Quality stocks.

Longer term, we argue that we are entering a new regime of higher inflation, higher interest rates and higher commodity prices for longer, due to increased geopolitical tensions as well as deglobalisation and decarbonisation trends. This new regime should favour companies producing physical goods as opposed to digital ones, which represents a sharp reversal of the trend witnessed since the Global Financial Crisis. This environment is positive for Value stocks, in particular cyclicals such as Materials and Industrials as well as Financials. Quality stocks should also continue to rerate as strong fundamentals including a healthy balance sheet, high profitability and cash flow generation, should be rewarded in a lower liquidity world.

For Growth stocks, the recent headwinds may become permanent due to higher interest rates as well as increased competition and regulation leading to valuation multiples stabilising at a lower level than the Covid period. There are still some pockets of growth, notably the companies exposed to automation or decarbonisation, but for the Growth style to perform again in a meaningful way we would need to witness new innovation similar to the invention of the internet; clearly this level of innovation is rare.

2022 style performance review

Looking at the MSCI style indices, style performance has been less pronounced this year compared to the past three years where we saw a very volatile market with large variations in performance, notably between Value and Growth. So far in 2022, Small Caps have been the best performing style, followed by Value. Quality stocks are also outperforming, while Growth stocks are lagging for the second year in a row (Exhibit 1).

Decomposing MSCI EM Value Index outperformance

Similar to 2021, the lack of a few large names explains most of the Value style's outperformance this year. Decomposing the MSCI EM Value Index's performance by sector (Exhibits 2 and 3), the major difference between 2021 and 2022 is the fact that Consumer Discretionary names – which were the main source of alpha in 2021 – have performed in line so far this year. This is primarily because of one Chinese e-commerce stock which is now the largest name in the Value index, well above its weight in the core index (the MSCI EM Index), and the stock's 45% drop this year has hurt relative performance.

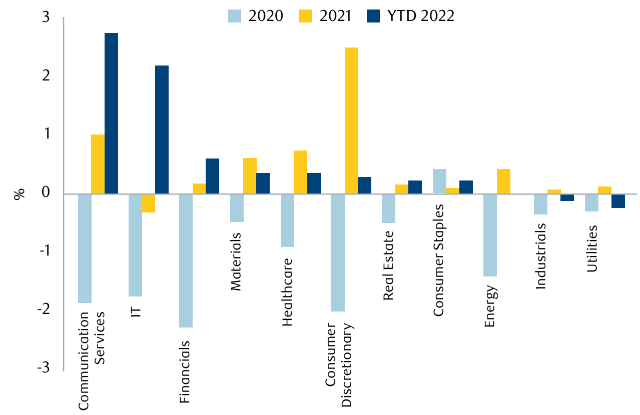
> "Looking at the MSCI style indices, style performance has been less pronounced this year compared to the past three years where we saw a very volatile market with large variations in performance, notably between Value and Growth."

Conversely, the 4% underweight position in the two worst-performing sectors this year, IT and Communication Services, benefited the Value index. Strong stock selection in these sectors also generated alpha, driven by a zero weight in two large tech names that are present in the core index and which have underperformed significantly this year. These two names alone account for almost half of the outperformance of Value. Finally, Value's large overweight to the Financials sector continues to contribute, as the sector outperforms.

Exhibit 1: MSCI style indices relative performance versus MSCI EM Index

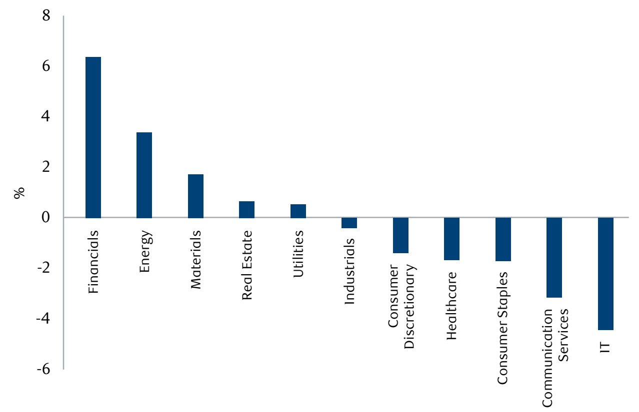
Sources: MSCI, RBC GAM. Data as at October 2022.

Exhibit 2: MSCI EM Value Index versus MSCI EM Index – alpha generation by sector



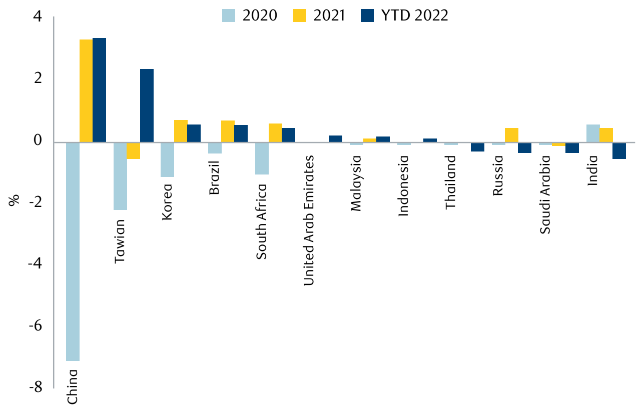
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 3: MSCI EM Value Index sectors – relative weights versus MSCI EM Index (2022)



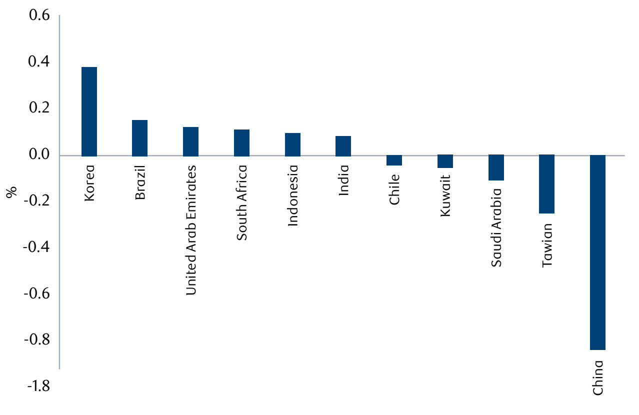
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 4: MSCI EM Value Index versus MSCI EM Index – alpha generation by country



Source: RBC GAM, MSCI. Data as at October 2022

Exhibit 5: MSCI EM Value Index countries – relative weights versus MSCI EM Index (2022)



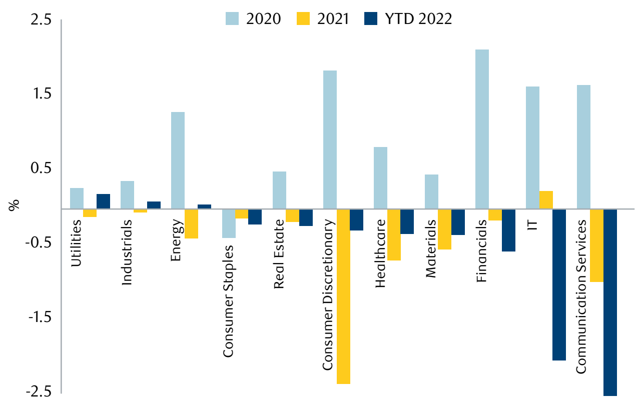
Source: RBC GAM, MSCI. Data as at October 2022

Looking at countries (Exhibits 4 and 5), Value's outperformance has come entirely from stock picking within countries as positioning is fairly similar between the MSCI EM Value Index and the core index. China remains the major driver of alpha generation through stock selection, marking a complete reversal from 2020. The main difference compared to 2021 is the large positive alpha coming from Taiwan, mainly due to the Value index's zero weight in a Taiwanese semiconductor name compared to a 7% weight in the core index.

Decomposing MSCI EM Growth underperformance

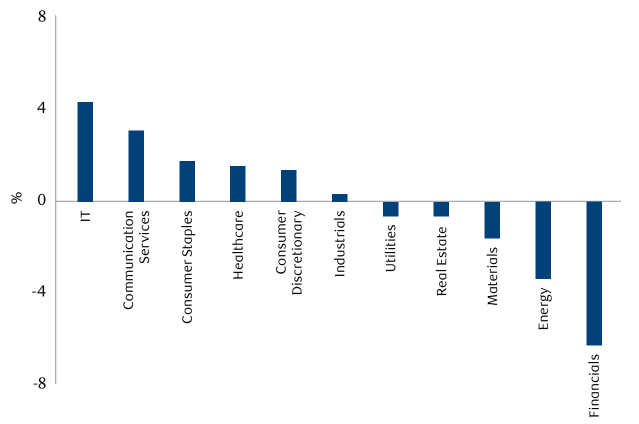
The same alpha decomposition for the Growth style shows that the underperformance comes from overweight positions in IT and Consumer Services, which have both strongly underperformed in 2022 (Exhibits 6 and 7). Stock selection was also a detriment to relative performance in both sectors. The Growth index's underweight to Financials also hurt, as the sector has outperformed this year.

Exhibit 6: MSCI EM Growth Index versus MSCI EM Index – alpha generation by sector



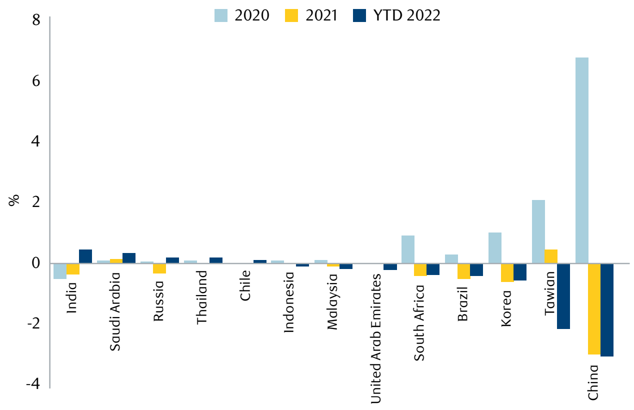
Source: MSCI, RBC GAM, Factset. Data as at October 2022.

Exhibit 7: MSCI EM Growth Index sectors – relative weights versus MSCI EM Index (2022)



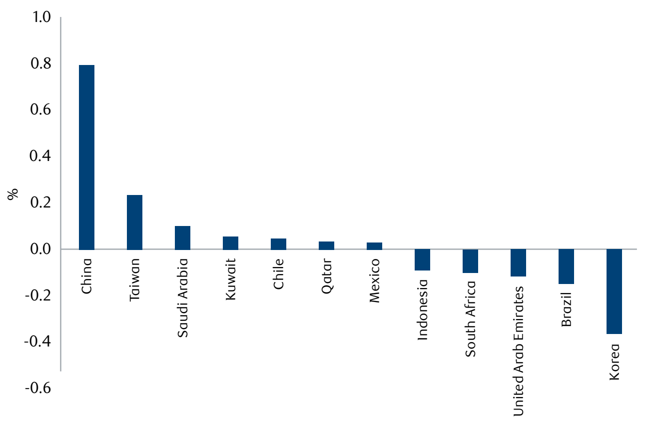
Source: MSCI, RBC GAM, Factset. Data as at October 2022.

Exhibit 8: MSCI EM Growth Index versus MSCI EM Index – alpha generation by country



Source: RBC GAM, MSCI. Data as at October 2022.

Exhibit 9: MSCI EM Growth Index countries – relative weights versus MSCI EM Index (2022)



Source: RBC GAM, MSCI. Data as at October 2022.

Looking at countries, stock selection has been the main driver of the Growth style's underperformance this year (Exhibits 8 and 9). Compared to 2021, which was a poor year for Growth stocks, the large underperformance in China has now also spread to Taiwan. We had previously argued that Taiwan was too expensive as expectations for continued stellar earnings growth in the technology sector, accelerated by Covid, were proven to be incorrect as economic reopening and high inflation has weighed on electronic good sales, most notably smartphones which are down 9% year-on-year, as of the end of September, with potentially more weakness to come.

2023 styles outlook

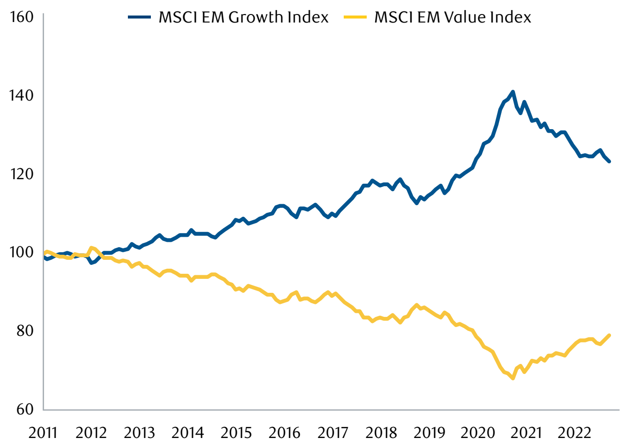
The Growth style has now been underperforming Value since November 2020. Since then, a succession of events (Exhibit 10) have made Growth stocks increasingly less attractive to investors and the Value rally has continued. However, as Growth stocks outperformed for so long and to such a large extent, Value stocks are still materially lagging Growth stocks on a 10-year view (Exhibit 11).

Exhibit 10: The transition from Growth to Value

November 2020	February 2021	November 2021	February 2022
▪ COVID vaccination efficacy higher than expected ▪ U.S. presidential elections – Biden victory	▪ Expectations of regulation in developed markets ▪ Arrival of regulation in Chinese internet sector	▪ Shift of market mindset around inflation ▪ Creation of new expectations around rate hikes	▪ Russia invades Ukraine as geopolitical tensions erupt ▪ Renewed fears that inflation will remain high, with particular impacts on food and energy

Source: RBC GAM.

Exhibit 11: EM relative style indices performance

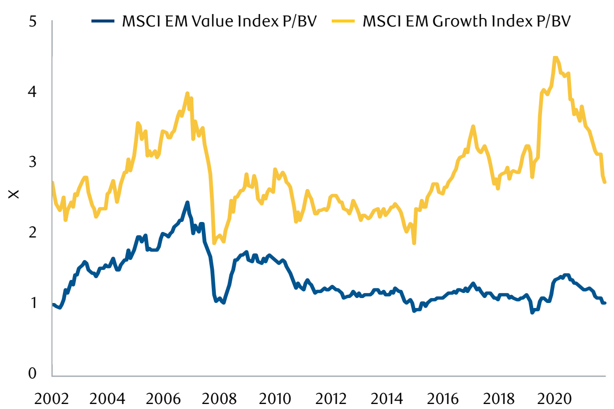


Source: MSCI, RBC GAM. Data as at October 2022.

In the short term, we argue that Growth stocks in EM are still too expensive compared to Value stocks. Exhibits 12 and 13 show that, despite a large drop in the valuation of Growth stocks, Value stocks still trade at a 63% discount to Growth stocks. This compares to a long-term average discount of 51%.

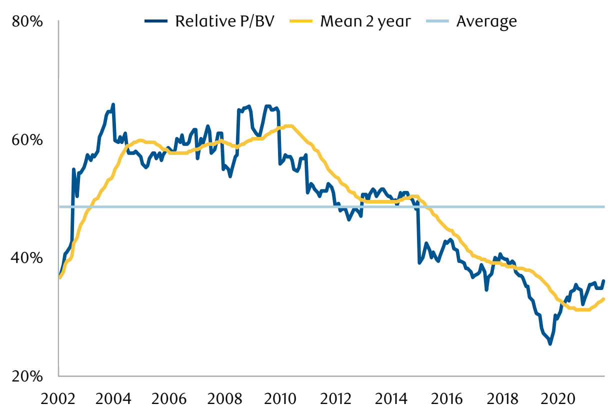
The main driver of Growth's outperformance in EM in the past few years came from Chinese stocks exposed to the digitalisation theme. We do not expect to see a rerating of these stocks for some time and we could see a continued derating of the weakest ones given the current regulatory, competitive and higher interest rate environment. Companies will have to focus more on profitability, which means spending less and growing less, leading to a further derating of Growth stocks. In our view, few stocks will do well and take advantage of that new environment. We expect the most profitable incumbents to perform the best. For now, the consensus still expects relatively high revenue growth for the fastest growing companies but we believe there is downside to those forecasts.

Exhibit 12: MSCI EM Growth Index P/BV relative to MSCI EM Value Index P/BV



Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 13: MSCI EM Value Index P/BV relative to MSCI EM Growth Index P/BV

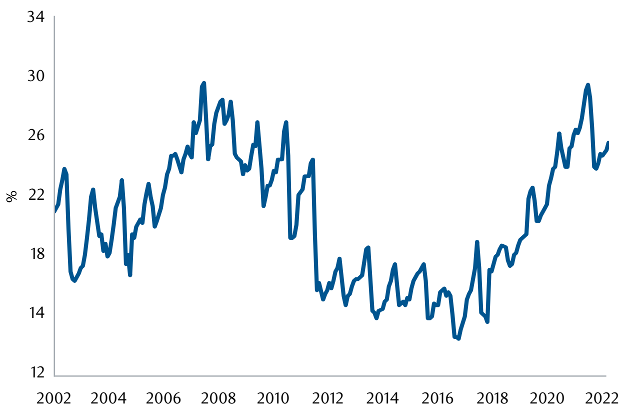


Source: MSCI, RBC GAM. Data as at October 2022.

Exhibits 14-17 show how the 30% highest growth names in the EM universe, measured by CAGR revenue growth in the next two years, trade at much higher multiples than the middle 40% of stocks in terms of growth, despite the difference in growth being similar to history. The chart also shows that growth expectations have come down recently, with the likelihood of there being further to go. Already for 2023, EPS growth expectations for the MSCI EM Growth Index are in line with the MSCI EM Value Index at only 3%.

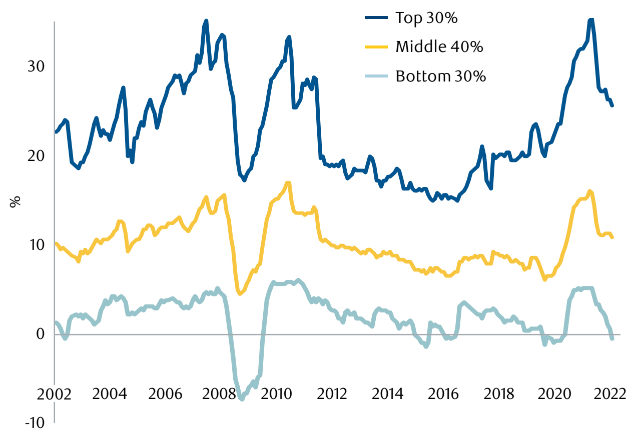
High growth names continue to look expensive

Exhibit 14: Growth spread – top growth/ bottom growth



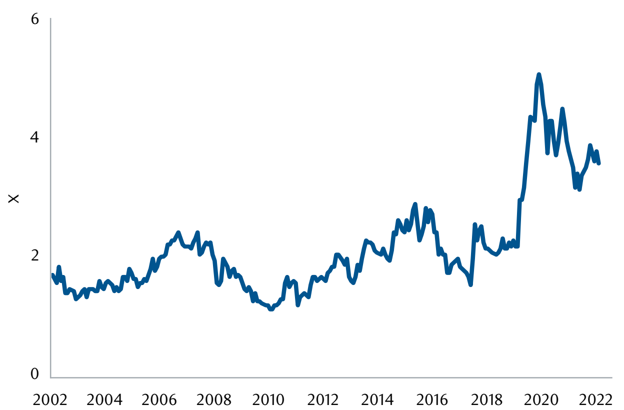
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 15: Median growth by growth fractiles



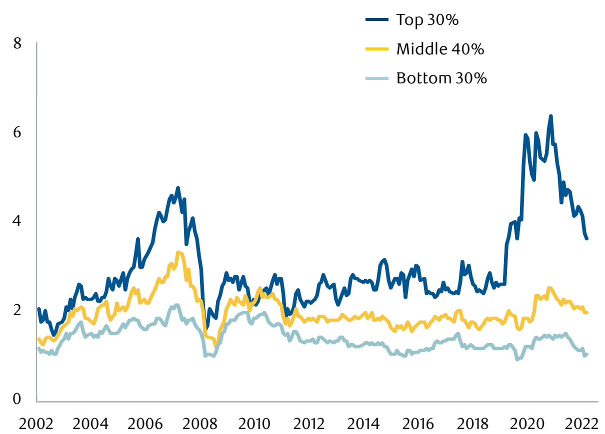
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 16: P/BV spread – top growth/ bottom growth



Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 17: Median P/BV by growth fractiles

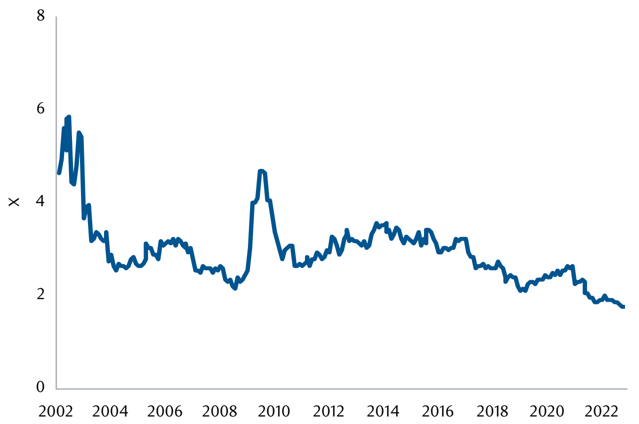


Source: MSCI, RBC GAM. Data as at October 2022.

The case for Value: Value has performed strongly so far in 2022 and the next few months may be less positive if the probability of a severe recession increases. This may continue until there is more clarity around the severity and depth of a recession, after which we could see a significant rebound in Value names. China reopening – as well as positive announcements around supporting economic growth –would be a further catalyst for Value stocks to do better. Furthermore, the profitability of Value names has improved recently with the spread of ROE between expensive and cheap names narrowing, while the spread of valuation is still very wide (Exhibits 18-21).

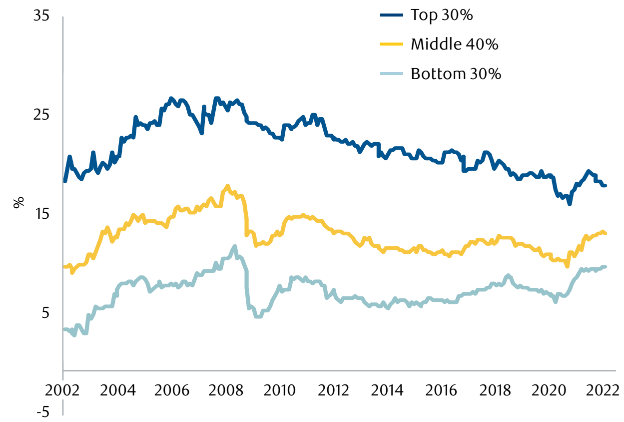
The case for Value – narrowing ROE spread between top/bottom P/BV names

Exhibit 18: ROE spread – top/bottom P/BV names



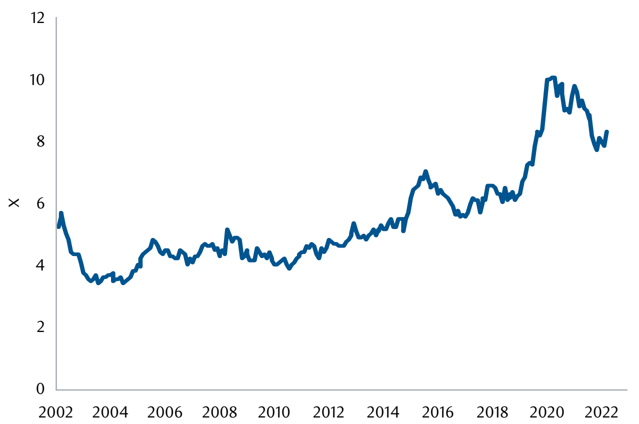
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 19: Median ROE by P/BV fractiles



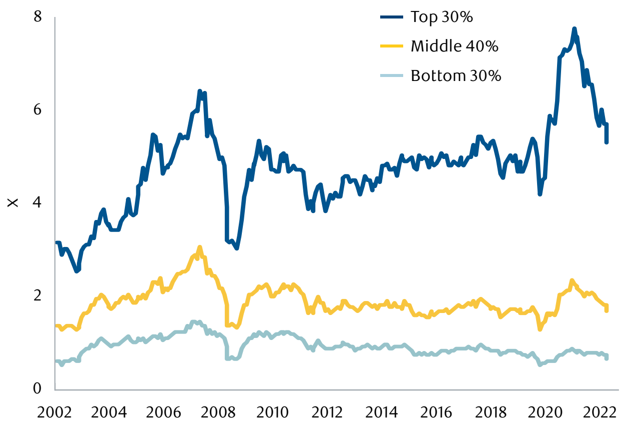
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 20: P/BV spread – top/bottom P/BV names



Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 21: Median P/BV by P/BV fractiles

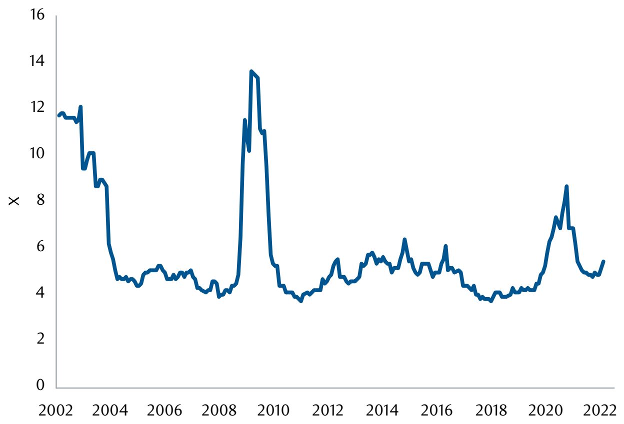


Source: MSCI, RBC GAM. Data as at October 2022.

As mentioned previously, Quality names are extremely cheap currently, particularly the middle segment which trades at the same valuation levels as low-quality names, despite a much higher median ROE (Exhibits 22-25). This is an anomaly which we expect should correct. As interest rates increase globally and investors look more closely at the quality of a company's operations, we expect Quality stocks to do better.

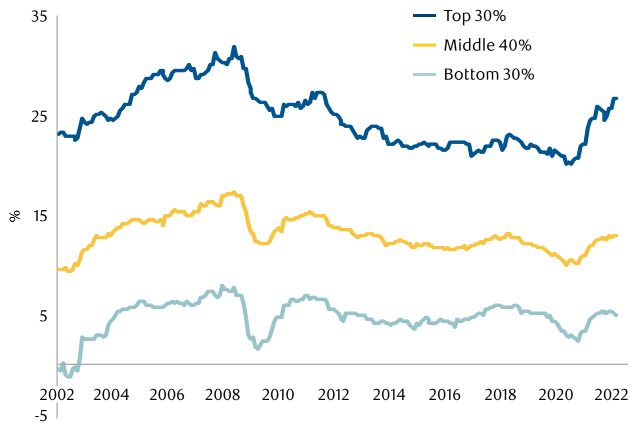
The case for quality – valuation of high and mid ROE names look attractive

Exhibit 22: ROE spread – top ROE/bottom ROE



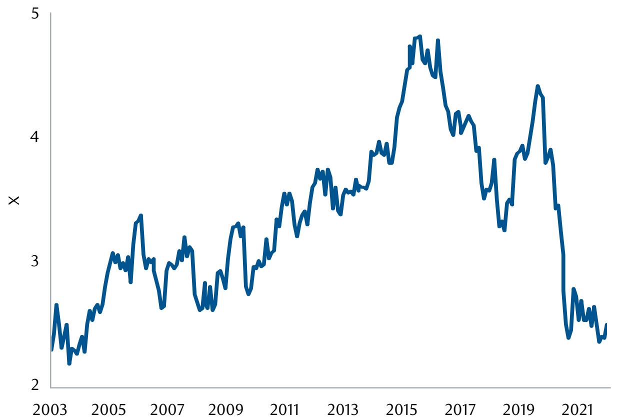
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 23: Median ROE by ROE fractiles



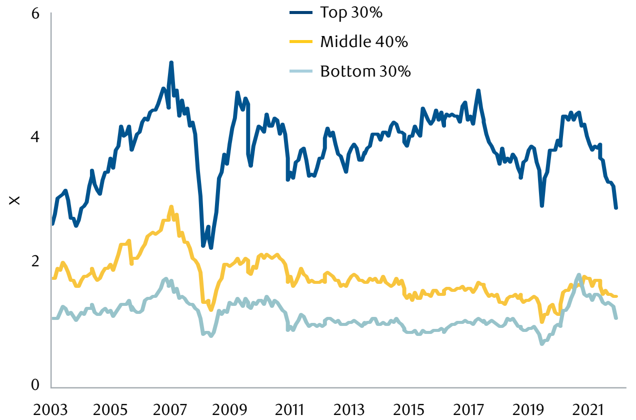
Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 24: P/BV spread – top ROE/bottom ROE



Source: MSCI, RBC GAM. Data as at October 2022.

Exhibit 25: P/BV by ROE fractiles



Source: MSCI, RBC GAM. Data as at October 2022.

Long-term styles outlook

Looking at long-term data, we believe that the premium at which Growth stocks still trade is explained by the belief that strong EPS growth will be sustained in the coming years. In the analysis in Exhibit 26, we compute the breakeven EPS growth over the next 10 years. In other words, this means the EPS growth that will be required by Growth stocks in order to justify their premium valuation versus Value stocks. As Growth stocks have underperformed over the past two years, the breakeven earnings growth has dropped from 25% to just below 20%. This number remains high compared to a 10-year average of about 15% and when looking at the much lower consensus long-term earnings forecasts we struggle to reconcile valuations and fundamentals.

We believe the gap in performance between Growth and Value stocks should close further as we enter a new regime. After decades of globalisation, the Covid pandemic followed by the war in Ukraine have provided a wakeup call to many countries around the world. These shocks have exposed countries' vulnerabilities, namely that they are highly dependent on a handful of sometimes hostile nations not only for their food and energy needs, but also for other essential products such as electronic goods.

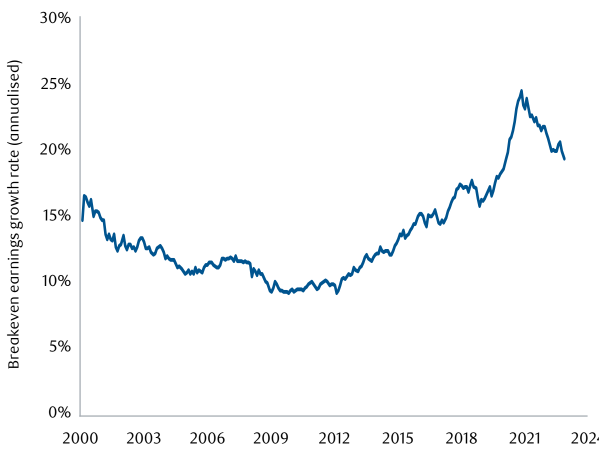
Furthermore, risks over China invading Taiwan, while still low, have marginally increased lately as a result of President Biden's harsher tone and actions towards the second-largest economy in the world. Such geopolitical tensions have added to the view that inflation may be higher for longer due to costly re-onshoring. This move to deglobalise the world economy is likely to fuel inflation and benefit cyclical sectors, as infrastructure will need to be developed closer to the consumer.

The other key trend that we believe could support higher inflation for longer is decarbonisation, which will be the solution for many countries to reduce their dependency on oil and gas exporters. Again, this move will take decades to achieve and it will likely lead to higher commodity prices, infrastructure spending and higher inflation due to the more costly price of energy. Investors looking for Growth should look to those names exposed to the decarbonisation theme rather than the previous winners from the digitalisation trend. We expect to see a continued rotation out of digitalisation-related sectors.

> **"Strong balance sheets, profitability and cash flow generation should be rewarded in this type of environment."**

Finally if, as we expect in the new regime, liquidity is less abundant for a long period of time, this should be positive for Quality names. Strong balance sheets, profitability and cash flow generation should be rewarded in this type of environment. High-quality companies will be able to take advantage of the challenging financial conditions in which zombie corporates will cease to exist; there will be more opportunity for M&A and market share gains. Notably in a higher-inflation environment, companies with strong pricing power will be the main beneficiaries.

Exhibit 26: Breakeven earnings growth between MSCI EM Growth Index and MSCI EM Value Index (10-year horizon)



Growth versus value breakeven analysis: assumptions

Years	MSCI EM Value	MSCI EM Growth
Price	100.00	100.00
P/E	7.13	14.05
Trendline EPS	$18.13	$8.41
Trendline earnings growth	5.39%	4.67%
Discount rate	6.35%	6.35%

Earnings growth required to justify growth premium

Years	Value earnings	Cumulative earnings	Present value of cumulative earnings (MSCI EM Value Index)	Earnings growth required for growth to catch up to value (annualised)
0	$18.13			
1	$19.11	$19.11	$17.97	127.0%
2	$20.14	$39.24	$35.77	72.4%
3	$21.22	$60.47	$53.41	51.5%
4	$22.37	$82.83	$70.90	40.5%
5	$23.57	$106.41	$88.23	33.7%
6	$24.84	$131.25	$105.40	29.2%
7	$26.18	$157.44	$122.42	25.9%
8	$27.60	$185.03	$139.28	23.4%
9	$29.08	$214.12	$155.99	21.4%
10	$30.65	$244.77	$172.55	19.8%
11	$32.31	$277.07	$188.96	18.6%
12	$34.05	$311.12	$205.23	17.5%
13	$35.88	$347.00	$221.35	16.6%
14	$37.82	$384.82	$237.32	15.8%
15	$39.86	$424.68	$253.15	15.1%

Source: RBC GAM. Data as at 31 October 2022.

Source: RBC GAM. Data as at 26 October 2022. The chart shows the annualised earnings growth required from the MSCI EM Growth Index to generate the same cumulative profits, discounted back to present values, as the MSCI EM Value Index over a ten-year horizon.

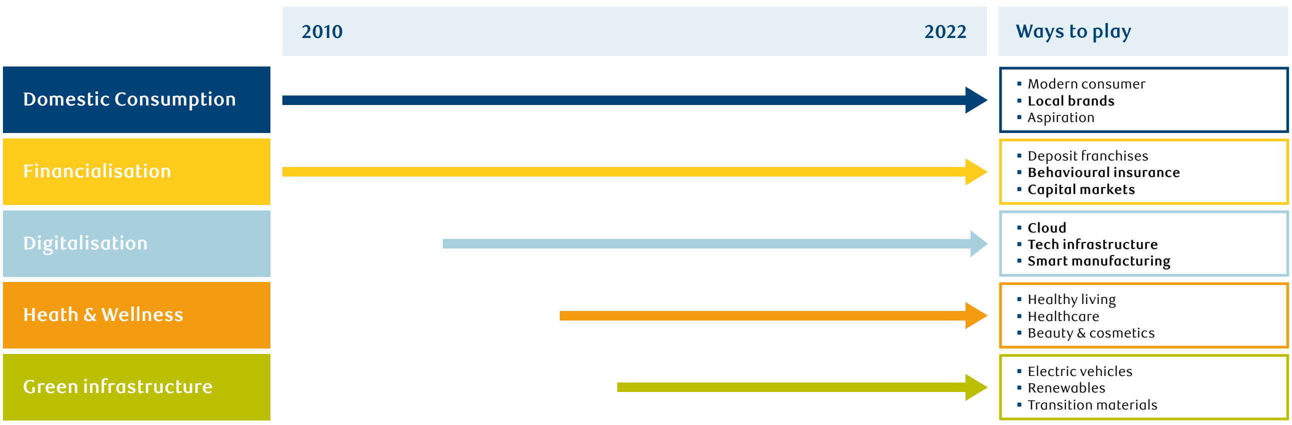
Investment themes review

Our top-down positioning continues to be driven by long-term themes. These themes are multi-decade global phenomena that have the power to endure economic cycles. We believe that this approach is particularly relevant in the current environment, with the era of low interest rates and easy money now firmly behind us. With growth becoming increasingly difficult to come by, positioning our portfolios in areas of long-term sustainable growth is more important than ever.

We focus on five key themes in our portfolios: Domestic Consumption, Financialisation, Health and Wellness, Digitalisation and Green Infrastructure (Exhibit 1). We have had these themes in place for a number of years and while we still believe that the long-term case for each theme remains intact, refreshing the ways we play the themes and ensuring we closely monitor their evolution is of upmost importance. Over the past year we have worked on the following:

- Within the ways to play our Domestic Consumption theme, we have updated 'Brands' to 'Local brands' in order to better define what we look for.
- Within Financialisation, we have refreshed two of the ways to play the theme:
  - We have changed 'Stock exchanges' to 'Capital markets' in order to reflect a broader opportunity set.
  - We have updated 'Insurance' to 'Behavioural insurance' in order to specify the types of companies we look for.
- We have refreshed the ways to play our Digitalisation theme in order to reflect what we now see as being the key growth drivers.

Exhibit 1: Investment themes and ways to play



Source: RBC GAM, as at 30 September 2022. Note: ways to play the themes in bold represent recent changes.

Domestic Consumption

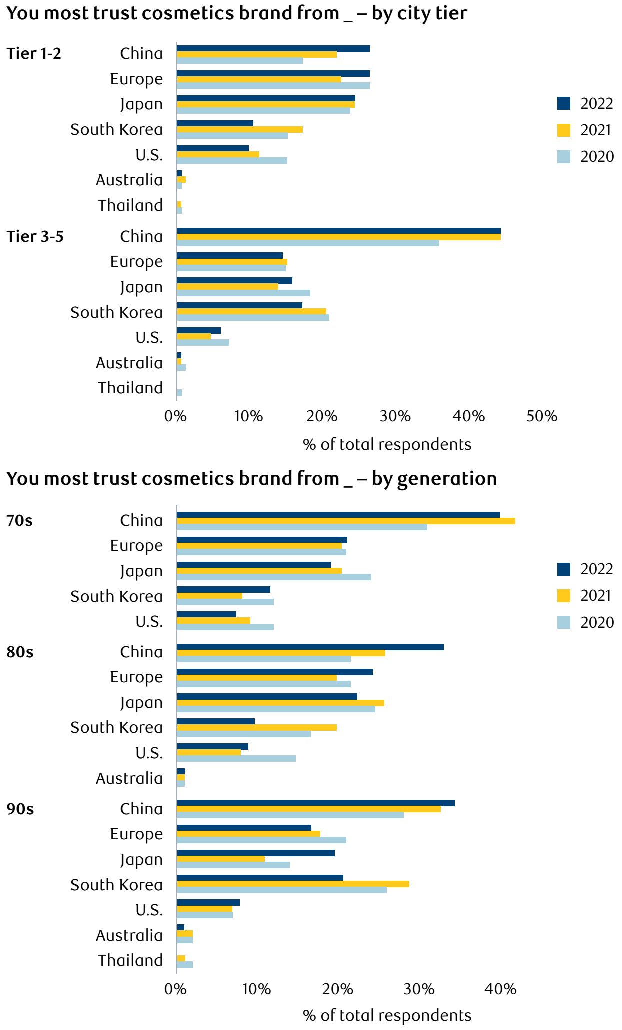
Domestic Consumption has been an important theme in EM for the past decade and has always represented a significant weight in our portfolios. Although EM consumption has already come a long way, we believe the theme still has significant growth potential driven by structural factors such as long-term urbanisation trends, an under-levered consumer and technological advancements. Naturally, the ways we play the theme have evolved over the years. This year, we made one change to the way we play our Domestic Consumption theme, updating 'Brands' to 'Local brands'.

The rise of local brands

There have been two key developments in recent years which have accelerated the rise of local brands at the expense of multinationals:

1. **Re-localisation of company supply chains**: Covid, coupled with rising geopolitical tensions, has caused major disruptions to global supply chains. This has provided local brands with production closer to the end market an opportunity to gain market share from the global players.
2. **Rising consumer demand for local brands:** improvements in product quality and design means that local brands are better able to cater to local tastes and have gained trust amongst local consumers. Exhibit 2 shows increased trust in local cosmetics brands amongst Chinese consumers across different income levels and age categories.

Exhibit 2: Improved trust in local brands amongst Chinese consumers



Source: CQi Surveys, Credit Suisse. Data as at May 2022.

Financialisation

We expect financialisation to continue to grow in EM, supported by factors such as increasing access to financial products, technological advancements and low penetration levels (Exhibit 3). Within this theme, we find a particularly wide gap between the winners and the losers, with the winners able to maintain their competitive advantages over long periods of time. We therefore continue to focus on high-quality incumbents with the scale and technology to maintain their leadership.

Within Financialisation, we have made two changes to the ways we play the theme:

1. **Capital markets:** while stock exchanges continue to be well positioned, we identify broader opportunities across capital markets as access to financial products expands across developing countries. We look for businesses that have invested in technology, are exposed to diversified revenue sources and operate in monopolies.
2. **Behavioural insurance**: life and health insurance providers are exposed to a number of structural tailwinds including low penetration levels, a growing need for healthcare and increased life expectancy. Within insurance, we invest in purpose-driven organisations that are focused on technology and data. We have found that these types of companies are able to improve customer engagement, incentivise better behaviour, price risk more efficiently, and ultimately reduce underwriting risk over time.

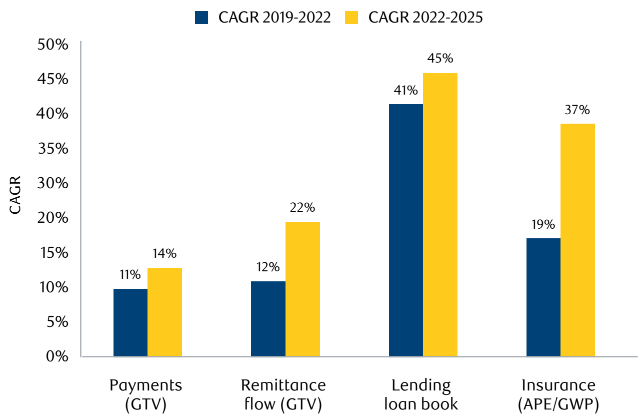
Digitalisation

Digitalisation, which encompasses all aspects of technology, has been an important theme in our portfolios for nearly a decade. Despite strong growth across the theme already, we see new avenues of growth driven by novel technologies that are becoming increasingly powerful, cost effective and scalable.

In light of these developments, we have refreshed the ways we play our Digitalisation theme:

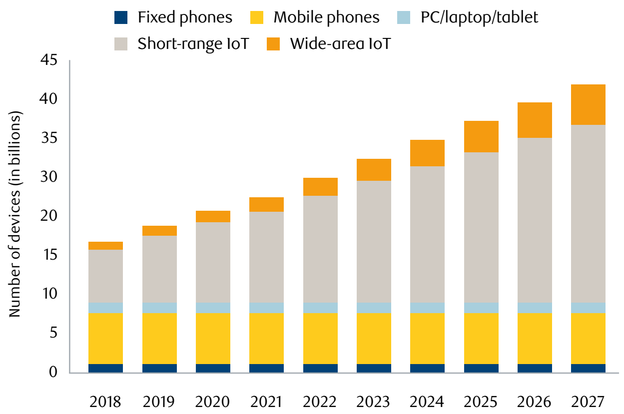
1. **Tech infrastructure:** the declining cost of semiconductors coupled with their increased power is leading to a truly connected economy, where connectivity is no longer limited to a smartphone and PC but to virtually all aspects of daily life. By 2027, there are expected to be over 40 billion connected devices globally, all requiring memory and logic chips as well as other tech infrastructure (Exhibit 4).
2. **Cloud:** the proliferation of connected devices is creating vast amounts of data to be analysed and exploited. The strong-expected growth in data is driving significant demand for cloud software and services in order to store, manage and process data more effectively.
3. **Smart manufacturing:** automation and data analytics are being increasingly embedded into company supply chains, in order to drive efficiency, reduce costs and improve the customer experience. Players with superior experience and a technological edge in specific industry solutions are likely to benefit.

Exhibit 3: Projected growth in digital financial services in South East Asia



Source: Bain analysis, Google, Temasek and Bain, e-Conomy SEA 2022. Notes: GTV = Gross Transaction Values; APE = Annual Premium Equivalent; GWP = Gross Written Premiums.

Exhibit 4: Expected growth in the number of global connected devices (in billions)



Source: Ericsson, Ericsson Mobility Visualizer. Data as at June 2022.

We recognise that investment themes are not static and it is therefore vital that we continue to monitor their evolution in order to ensure we are best positioned to capture future growth trends. We look forward to continuing our research efforts in this respect.

ESG reforms

ESG and sustainability-related reforms are becoming increasingly important for countries in EM. Countries that implement ESG-related reforms are more likely to have sustainable economic growth compared to ones that do not prioritise these reforms. By being aware of specific ESG-related risks and opportunities at a country level, we can address these matters with management of companies operating across emerging countries.

This section focuses on three examples where we have seen positive developments in emerging countries recently, in terms of specific ESG-related reforms:

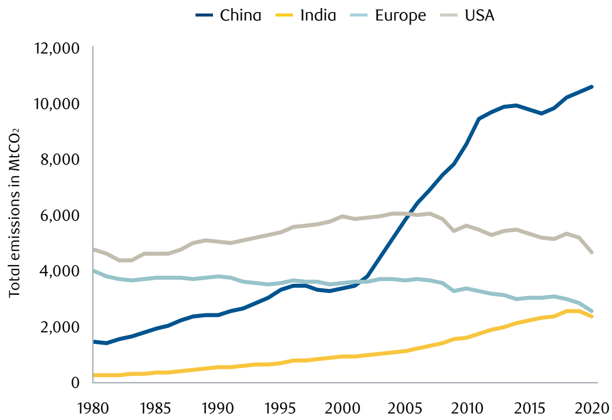
1. The net-zero commitment of India,
2. Improving gender diversity at management and board level in EM countries,
3. Increasing ESG disclosure across China A-share listed companies.

India's net-zero commitment: environmental factors

India's announcement at COP26 that it aims to reach net-zero emissions by 2070 and meet 50% of its electricity requirements from renewable energy sources by 2030 is likely to be significant in efforts to address climate change[10]. The rapid growth in fossil energy consumption has meant that India's CO_2 absolute emissions have risen to become some of the highest in the world (Exhibit 1). Yet, India's CO_2 emissions per capita are still low and much below that of other large economies (Exhibit 2).

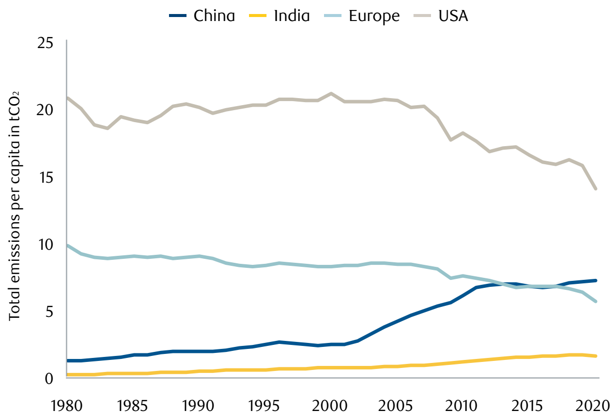
India's size, and its growth potential, means that its energy demand is set to grow by more than that of any other country in the coming decades[11]. On its pathway towards net-zero emissions by 2070, a key question is where the future additional energy supply will come from. An important challenge for India will be how it transitions its economy away from coal, which accounts for nearly half of all energy supply, to more low-carbon sources (Exhibit 3). For India, the coal sector is intertwined with many other areas of the economy and coal levies are an important revenue source for central government and coal-producing states (amongst some of the poorest in the nation), and this could impact labour markets[12].

Exhibit 1: Total CO_2 emissions among major global economies



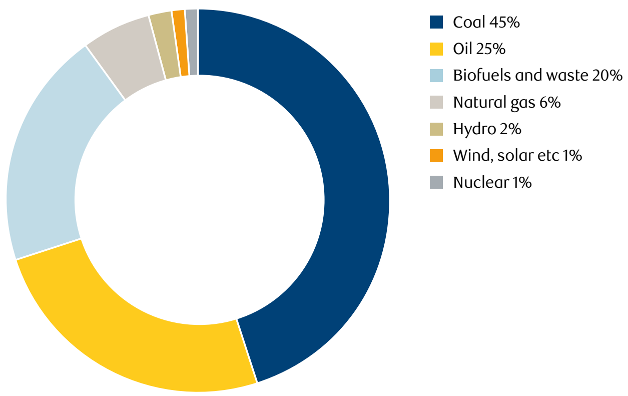
Source: Global Carbon Atlas. Data as at December 2020. Figures are in in $MtCO_2$.

Exhibit 2: Total CO_2 emissions per capita among major global economies



Source: Global Carbon Budget. Data as at December 2020. Figures are in tCO_2.

Exhibit 3: India's sources of energy supply



Source: IEA, Jefferies. Data as at November 2021.

[10, 11] India's clean energy transition is rapidly underway, benefiting the entire world – Analysis - IEA.
[12] Jefferies research: 'COP26: Big Numbers, Real Change?' (November 2021).

India will attempt to pioneer a new model of economic development that is focused on environmental reforms, in contrast to the carbon-intensive approaches of other countries in the past. The Prime Minister, Narendra Modi, has announced ambitious targets for 2030, including installing 500 gigawatts of renewable energy capacity[13]. Given the complexities involved in a net-zero transition for India, how this is financed is likely to be an important question going forward. In introducing India's net-zero target, Modi called for developed economies to step up climate finance commitments. Climate finance recognises that the contribution of countries to climate change and their capacity to deal with the implications varies substantially between the developed and developing world. Increased climate finance from developed nations would provide crucial tailwinds for a low-carbon technology rollout in India.

Improving gender diversity in EM countries: social factors

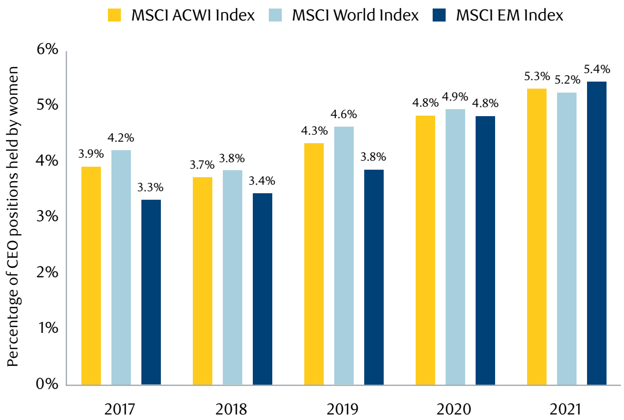
Diversity has been, and continues to be, an important area of engagement for our team. To that end, it is positive to see that the representation of women across senior management positions has been increasing in EM countries. As shown in Exhibit 4, the share of female CEOs in EM, as represented by the MSCI EM benchmark, has been on an upwards trend. In 2021, it slightly overtook the share of women CEOs in DM (5.4% in the MSCI EM Index compared to 5.2% in the MSCI World Index and 5.3% in the MSCI ACWI Index). A similar trend can be seen in the prevalence of women CFOs in EM, where the share is even greater at 19.2% in the MSCI EM Index, versus 12.8% in the MSCI World Index and 15.8% in the MSCI ACWI Index.

Looking at gender diversity on boards of directors, the representation of women on boards across EM varies greatly, but continues to show improvements overall year-on-year, and as such, represents a positive trend (Exhibit 5). South Africa stands out, with 34% of all director seats held by women, as of 2021. On the other hand, Saudi Arabia scores particularly poorly, with only around 2% of seats held by women. South Korea also scores relatively low but it is encouraging to see a significant improvement in the last few years.

> **"India will attempt to pioneer a new model of economic development that is focused on environmental reforms, in contrast to the carbon-intensive approaches of other countries in the past."**

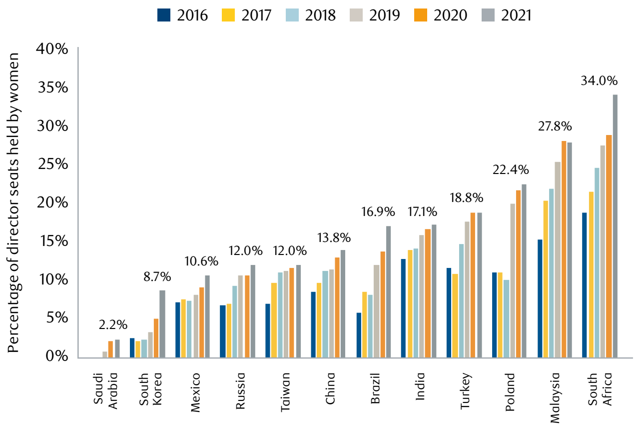
South Korea is an example of a country reforming its legislation to improve diversity. South Korea recently revised its Financial Investment Services and Capital Markets Act ("FSCMA") to ensure that the boards of publicly-listed companies (with assets exceeding KRW2 trillion) will not be comprised entirely of members of one gender. This is expected to lead to higher ESG performance ratings and increased representation of women on boards[14]. We would expect similar reforms and regulation to be introduced in more EM countries going forward, which should help further improve the participation of women on boards.

Exhibit 4: Percentage of women CEOs across MSCI ACWI, EM and World indices



Source: MSCI ESG Research, November 2021.

Exhibit 5: Representation of women on boards has grown steadily across EM countries



Source: MSCI ESG Research. Data as at November 2021.

[13] India aims to add 500 GW of renewables by 2030 | S&P Global Market Intelligence (spglobal.com).
[14] Mondaq com: Amendments of the Financial Investment Services and Capital Markets Act of Korea requires board diversity.

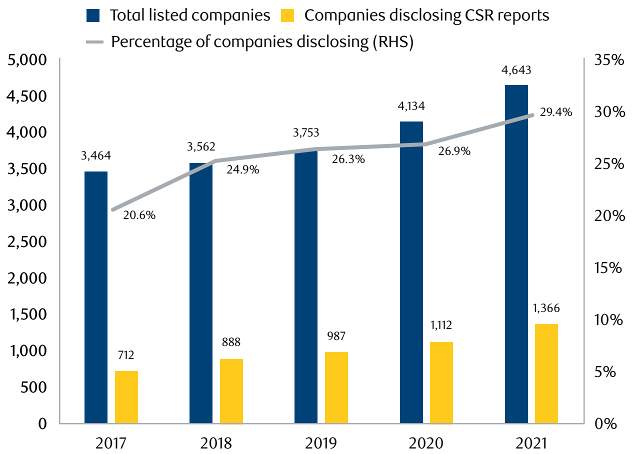
Increasing ESG disclosure by listed Chinese companies: governance factors

The level of ESG disclosure of Chinese A-share listed companies has continued to improve over the last five years as the number and proportion of listed companies that actively disclose ESG information has increased. In 2021, there were a total of 1,366 China A-share listed companies that disclosed Corporate Social Responsibility ("CSR") reports, accounting for 29.4% of all listed companies (Exhibit 6). As illustrated, the number and percentage of companies disclosing CSR reports has been increasing steadily. That said, there is still significant room for improvement, as less than one-third of companies overall currently disclose ESG reports.

A key reason for the lower disclosure of the Shenzhen, SSE Star and ChiNext boards is that these have higher shares of companies in the IT sector, which happens to be the sector with the lowest proportion of companies disclosing CSR reports[15]. The Shanghai Stock Exchange, on the other hand, is more diversified across sectors – for instance, there are more companies from the Financials sector that have the highest percentage disclosure of any sector at present.

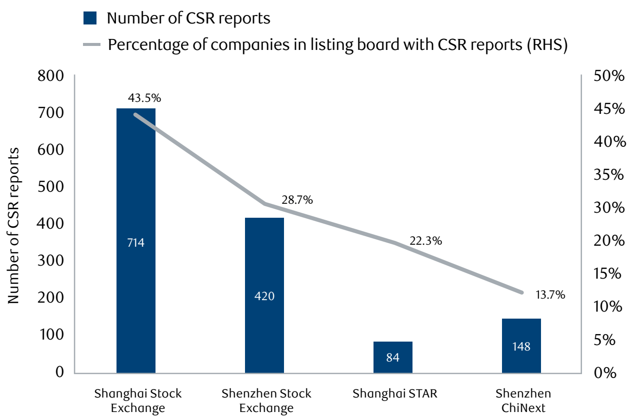
> "The level of ESG disclosure of Chinese A-share listed companies has continued to improve over the last five years."

Exhibit 6: Disclosure of CSR reports by A-share listed Chinese companies



Source: Nankai University Green Governance Database.
Data as at April 2022.

Exhibit 7: Number of CSR reports and the percentage of companies in listing board with CSR reports



Source: Nankai University Green Governance Database.
Data as at April 2022.

Looking at ESG disclosure by listing board, the highest number of CSR report releases came from the Shanghai Stock Exchange, with 43.5% of companies disclosing CSR reports. This is followed by the Shenzhen Stock Exchange board, the Shanghai Science and Technology Innovation Board (Shanghai STAR) and finally the Shenzhen ChiNext (Exhibit 7).

Looking ahead, it is probable that we will see a further increase in the number of companies producing CSR reports in China. In June 2022, the first China-focused ESG disclosure standard was introduced in the country. The guidance is comprehensive and covers 118 ESG metrics across topics such as climate change, governance mechanisms, labour rights and resource consumption. The guidelines were developed in compliance with China's existing domestic regulation, which should ensure that they are relevant for Chinese-listed companies. For now, the guidelines are voluntary, however, it is promising to see China increasingly focus on reforming its ESG disclosure.

[15] China Association for Public Companies.

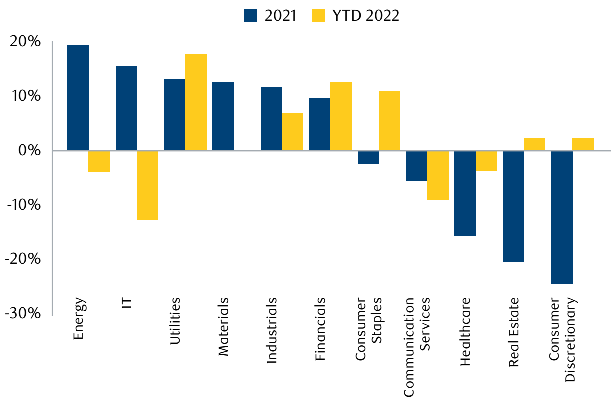
Sector analysis

Over the last few months, we have seen a sharp reversal in the performance of the best performing sectors in 2021 and up to the first quarter of 2022. The Commodities sectors of Energy and Materials and the IT sector, which were among the best three performing sectors in 2021, are now among the worst performing in 2022 (Exhibit 1). While all EM sectors fell during 2022 to date, defensive sectors held up the best, with Consumer Staples, one of the laggard sectors in 2021, and the Utilities sectors suffering the smallest losses. The turn in trends speaks to a global shift from an environment characterised by the economic recovery from the Covid-19 pandemic, low inflation and low rates to one characterised by higher inflation and by a shift in monetary policy globally, resulting in higher rates and lower growth.

The higher rates and lower growth expectations have prompted earnings estimates downward revisions, with virtually all of the EM sectors seeing EPS cuts over the last twelve months. Looking ahead, we expect a slight improvement in MSCI EM Index earnings next year with Consumer Discretionary, Healthcare, Consumer Staples and Financials leading and Energy and Materials lagging (Exhibit 2).

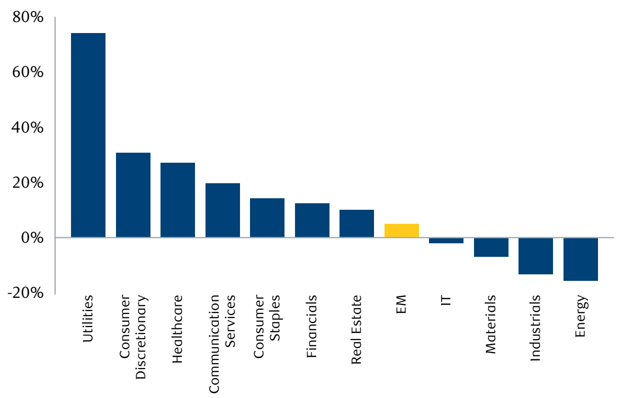
> "Over the last few months, we have seen a sharp reversal in the performance of the best performing sectors in 2021 and up to the first quarter of 2022."

Exhibit 1: MSCI EM sectors performance relative to EM



Source: RBC, MSCI, Bloomberg. Data as at October 2022.

Exhibit 2: MSCI EM sectors 2023 EPS year-on-year growth



Source: MSCI, IBES, Datastream, UBS.

In terms of valuations, Consumer Staples, Financials, Industrials, Healthcare and IT trade below long-term averages in terms of P/BV valuations. Communication Services, Energy and Utilities trade at premiums to their long-term averages. There is no evidence of any sector trading at extreme valuations (Exhibit 3).

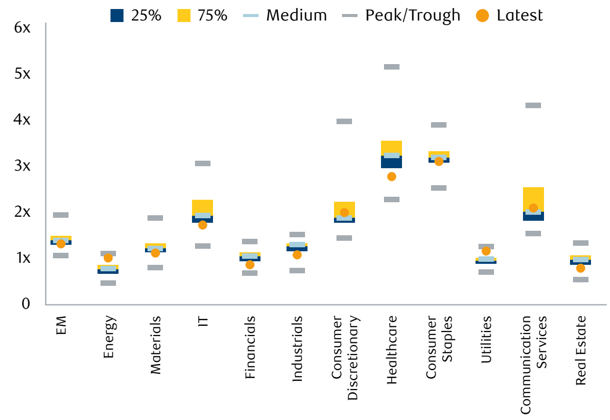
Overall, our sector strategy is driven by our long-term themes and, as a result, we have a preference for domestic sectors such as Consumer Staples, Consumer Discretionary and Financials. Looking forward to 2023, we don't expect any major change in terms of our sector's strategy. We remain cautious on the Materials sector as it is the most sensitive to global pricing trends, at a time when supply for many mined commodities is increasing and demand faces headwinds, ranging from higher rates to the China property sector slowdown. We continue to have no exposure to Oil, a sector that presents far too many challenges from a sustainability standpoint, and that in EM, primarily comprises state-owned companies that are also characterised by low returns and a low level of capital discipline. We are broadly neutral in terms of weight to the IT sector.

Consumer Staples

The Consumer Staples sector had a challenging first half of the year on input cost pressures from a very rapid increase in food prices, following the conflict in Eastern Europe. The underperformance left the sector trading at attractive valuations relative to its history and to other defensive sectors.

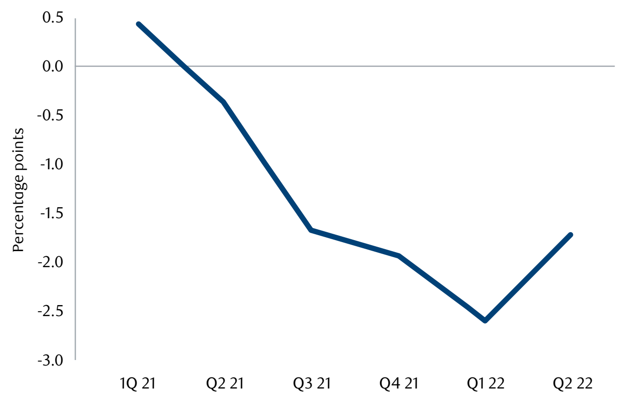
We have been well exposed to Consumer Staples for many years. In EM, there are many franchises in this area with successful brands, high and sustainable returns and strong growth supported by increasing GDP per capita and consumption. In addition to the many structural positives supporting our exposure, the Consumer Staples sector is in a good position cyclically for the following reasons: **1)** The main headwind, food inflation, has now become a tailwind since the Consumer Staples sector in EM is one of the region's biggest beneficiaries of easing food prices. Food inflation hurt the sector's margins for most of the past year, but global food pricing peaked in March and has come off sharply since, with gross margin starting to recover (Exhibit 4). **2)** Consensus revisions turned positive in August after 13 months of cuts and are now outperforming the region by a healthy margin (Exhibit 5). We think the turn marks the start of a more persistent trend as current forecasts look conservative relative to pre-pandemic and pre-conflict profitability.

Exhibit 3: MSCI EM sectors 12-month forward P/BV relative to their history



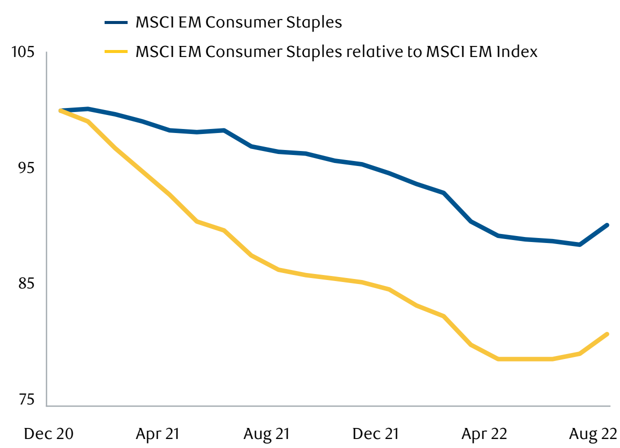
Source: RBC, Factset. Data as at October 2022.

Exhibit 4: EM Consumer Staples gross margin year-on-year change



Source: Revinitiv, Credit Suisse. Data as at October 2022.

Exhibit 5: EM Consumer Staples EPS revisions



Source: Revinitiv, Credit Suisse. Data as at October 2022.

Information Technology

Information Technology has been the worst performing sector in EM this year[16]. There have been two reasons for the weakness: **1)** the sector remains cyclical and higher inflation and interest rates are causing EPS downgrades, while also putting pressure on valuations; **2)** rising tensions between the U.S. and China, around the use of technology with U.S. content, have led to restrictions on the sale of advanced computing and semiconductor manufacturing equipment to China.

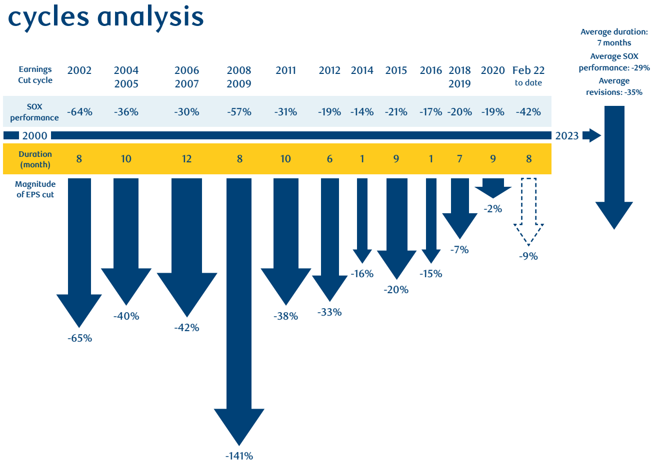
Our views on both points, and on how that affects our exposure to the sector, are as follows. We are long-term investors and we like to take long-term views. In this respect, the EM IT sector continues to be a key investment area for us. Within it, we like the semiconductor industry in particular as the industry has become more concentrated and barriers to entry have increased, resulting in higher and more sustainable returns. Big data, artificial intelligence (AI), cloud computing, smart factories, smart cities and e-commerce all represent areas that are leading to a steep acceleration in the rate of technological change. The drivers underpinning this acceleration are structural, but periods of cyclical weakness, such as the current one, tend to occur. We have reviewed prior cycles since 2002 (Exhibit 6) and found five factors that can help determine where we are in the current cycle. These factors are valuations, earnings estimates, magnitude of share price correction, length of the correction and inventory level.

On balance, we find that valuations have become more attractive but are far from extreme, and while the magnitude and length of the share price correction suggests the bottom may have been reached, traditional timing relative to earnings cuts and inventory levels across the whole semiconductors' supply chain suggest caution. EPS cuts, in particular, have been very small so far (-9% versus average -35%) and we see risk to EPS consensus estimates for next year. While stocks do in part recognise that viewpoint, we are still well above the lows of 2019 on most valuation metrics (Exhibit 7), with fundamental risks more likely to be worse than the prior tech cycle corrections, given the much higher level of inventory.

> "We are long-term investors and we like to take long-term views."

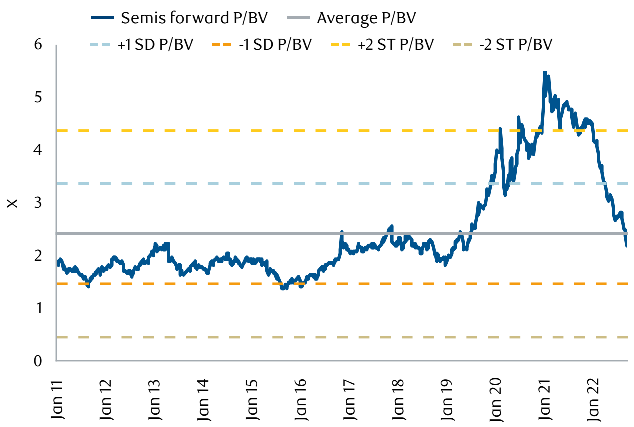
In terms of the escalating tensions between the U.S. and China, the latest round of U.S. restrictions on exports of semiconductors to China are a step-function wider and deeper than prior ones and add further complexity to the current outlook for the sector. This time, the U.S. government has not minimised the impact on its industry but has maximised the impact on China.

Exhibit 6: Semiconductor industry's past cycles analysis



Source: Credit Suisse, RBC, Bloomberg. Data as at October 2022.

Exhibit 7: EM Asia semiconductors' historical P/BV

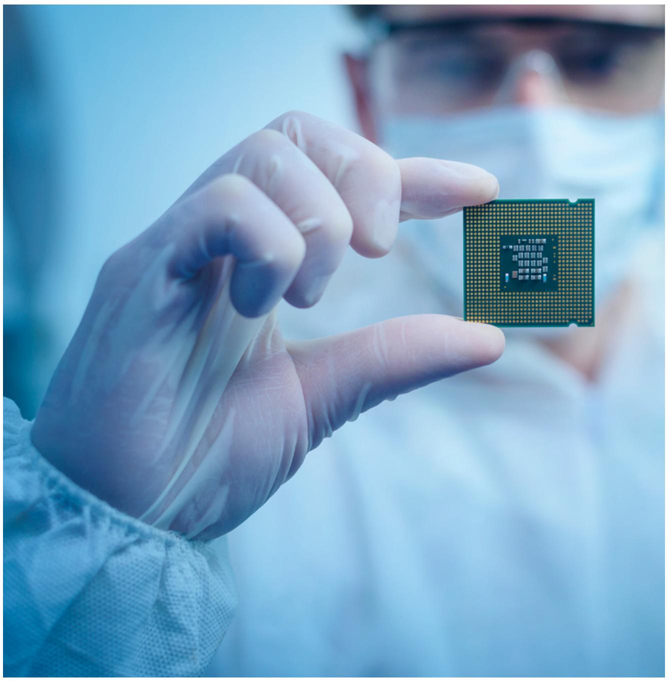


Source: MSCI, JP Morgan. Data as at October 2022.

[16] MSCI EM Index.

Albeit China is a fledging semiconductor industry, still years behind that of the U.S., however the gap is closing. The U.S. is trying to slow the China tech industry and reduce the pace at which the technological gap is narrowing. With the new policy, the U.S. is firmly focused on retaining control over so-called “chokepoint” (or as it is sometimes translated from Chinese “stranglehold”) technologies in the global semiconductor technology supply chain. There are four key chokepoints in the context of this discussion:

- **AI chip designs:** the U.S. does not want China to have advanced AI computing and supercomputing facilities, so it has blocked them from purchasing the best AI chips, which are all designed in the U.S. or in countries that are strong allies of the U.S., such as Korea, Japan and Taiwan.
- **Electronic design automation software:** the U.S. does not want China designing its own AI chips, so it has blocked China from using the best chip design software (which is primarily American) to design high-end chips.
- **Semiconductor manufacturing equipment:** the U.S. does not want China to have its own advanced chip manufacturing facilities, so it has blocked it from purchasing the necessary equipment. Naturally it has also blocked chip manufacturing facilities worldwide from accepting orders from Chinese IC design firms.
- **Equipment components:** the U.S. has blocked China from domestically producing semiconductor manufacturing equipment, by choking off access to U.S.-built components.



Our view is that while this may not be just the beginning, it is not the end. Data, and the tech infrastructure controlling it, have become the new must-have for a country’s strategic resource for competitiveness. This suggests that the race between the U.S. and China in this area will continue for much longer. In the short term, there are still loopholes that China can exploit, and these will be addressed relatively soon. As a result, there will be more U.S. directives which will be clarifications of existing and/or additional ones. In our view, the most likely outcome longer term, is a duplication of the tech supply chain, one for China and one for the U.S. and its allies. We see the following opportunities as a result of such duplication:

1. **Exposure to global leading edge technology:** leading edge expertise in semis or other tech areas will continue to be in high demand. We, therefore, remain invested in those tech companies at the top of the value chain, from both a technological and strategic standpoint. These companies tend to have very large market shares globally in their areas of expertise, achieved through competitive advantages based on R&D and technological leadership. They are strategically essential franchises and any loss from China exposure would be quickly recovered from other geographies and customers.

2. **Exposure to China domestic technology:** while the latest U.S. policy dramatically raises the obstacles to China’s production of an indigenous supply chain, China is not going to give up. China’s share of global semiconductor manufacturing capacity has grown from 9% in 2011 to 16% in 2021, making it the third-largest producer after South Korea and Taiwan. Longer-term implications for China’s tech sector could actually be positive as this accelerates China’s semiconductor and tech localisation efforts. From a bottom-up standpoint, this would entail focusing on tech companies that have negligible dependence on foreign technology or customers, and whose growth is entirely China focused.

Commodities

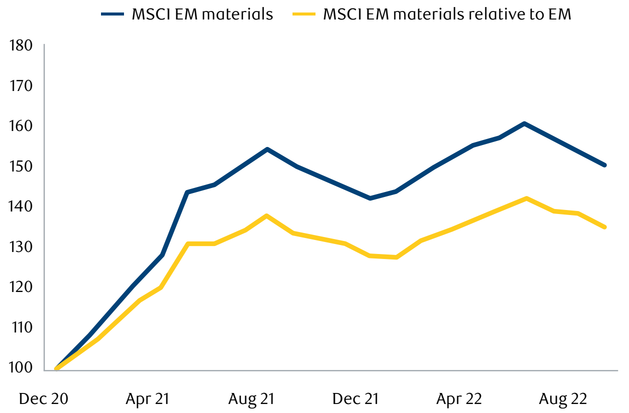
We have relatively low direct exposure to the commodities sectors, with no exposure to Oil, and selective exposure to Materials. Looking to 2023, we believe that EPS risk is relatively high, with current forecasts that look aggressive relative to the pre-pandemic trend, and revisions have started to reflect that view and have rolled over the past three months (Exhibit 8).

Relatively large supply increases (Exhibit 9), particularly for nickel and copper, could also put pressure on prices next year. Higher-cost structures and higher demand from low-carbon technologies, however, should be supportive of prices for selective materials. We expect copper, nickel, aluminium and lithium to have the highest potential of all commodities. This is due to a strong structural demand from the adoption of electric vehicles, coupled with supply-side headwinds from stricter environmental regulation and long lead times to add capacity.

Natural gas deserves particular attention. In the short to medium term, the market in Europe remains very vulnerable to further supply shocks caused by Russia supply cuts and lack of short-term viable alternatives. Despite the extraordinary rise in price that has occurred over the last six months, further upwards pressure cannot be ruled out in the short term. In the long run, we believe the gas market could rebalance owing to a potential end to the war and oncoming large supply of LNG from 2025 onwards.

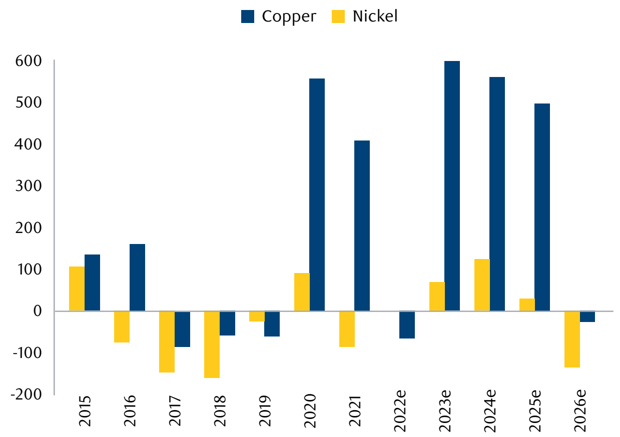
Being a concentrated market, oil has become increasingly managed, such that supply moves with demand. Hence, while prices may continue to be relatively firm in the short term, they also lack any material upside. We have no exposure to the sector. From a top-down standpoint, the long-term fundamentals for oil are challenged by the renewable energy transition. From a bottom-up standpoint, EM oil companies tend to be state-owned enterprises, have poor capital discipline and generate low returns.

Exhibit 8: MSCI EM Index EPS estimates – absolute and relative

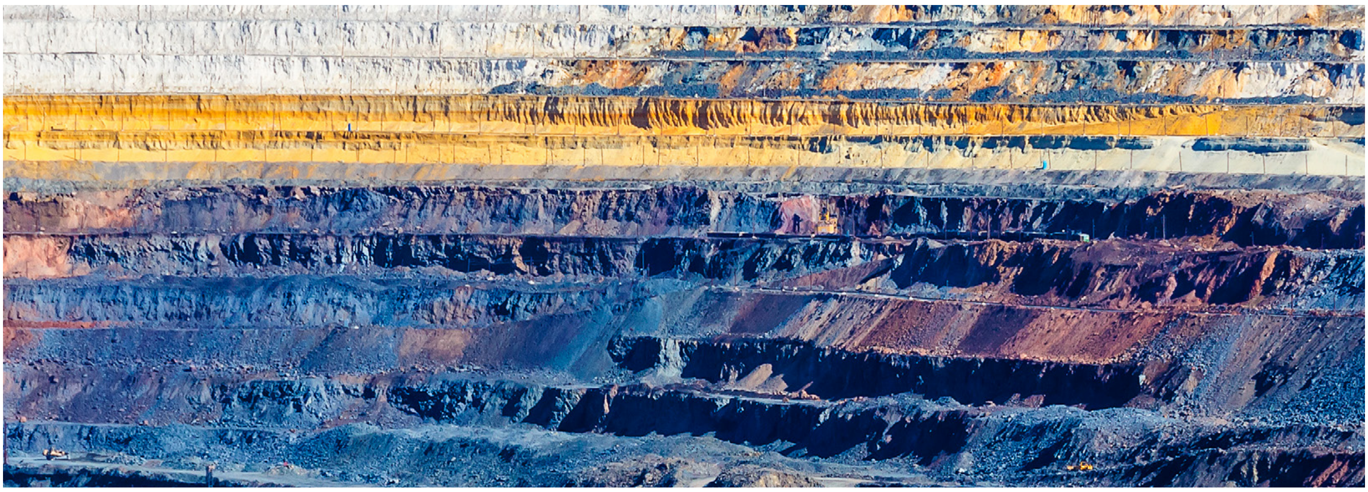


Source: Revinitiv, Credit Suisse. Data as at October 2022.

Exhibit 9: Nickel and copper market balance



Source: HSBC. Data as at October 2022. Estimates are shown for 2022-2026.



Financials

Financials represent our largest exposure in absolute terms and the second largest in relative terms. The sector has outperformed both in 2021 and in 2022 year to date, primarily driven by the strong performance of banks in Latin America and India. We continue to view the sector favourably and maintain our current exposure for the following reasons: **1)** Higher interest rates should prove to be highly supportive for EM banks' net interest margins ("NIM") and ROEs over the next two years; **2)** We see limited risk of further ROE disruption from fintech. Banks with strong deposit franchises and strong capital positions are likely to continue to maintain a significant competitive advantage over fintechs; **3)** Cyclically, EPS revisions are outperforming the region by an increasingly wide margin. Existing forecasts compared to historical profitability still appear conservative and **4)** Valuations are still attractive. Although banks have outperformed, strong revisions have kept multiples relative to the region and global peers at an attractive level (Exhibit 3).

The insurance sector suffered from lacklustre performance in 2022. A rising interest rate environment is a double-edged sword to insurance companies, positive to Value of New Business ("VNB") but negative to Embedded Value ("EV"). Sensitivities to interest rates vary across insurers, but on balance, tend to be negative. We believe that this explains the lacklustre performance of the sector in 2022. Valuations have, however, factored in this interest rate cycle and, in our opinion, the structural elements supporting the exposure should become more evident. We continue to be invested in insurance companies that have high returns, supported by a deep moat, built on a combination of distribution networks and technology that cannot be easily replicated.

China strategy

A challenging economic backdrop has weighed on Chinese equities this year, and China has been one of the worst-performing markets in the region, with the MSCI China Index down 42.8%, as at the end of October 2022[17]. In this section, we focus on the country's topical areas.

Key takeaways from the 20th Party Congress

China concluded its 20th Party Congress over the weekend of 22nd-23rd October 2022, with President Xi seemingly certain to be reappointed next March to an unprecedented third five-year term.

While the reappointment was widely anticipated, Xi's replacement of the core leadership team of the Politburo Standing Committee ("PSC") with close associates rattled markets and raised concerns over Xi's consolidation of power and the removal of checks and balances. The lack of diversity in the PSC also implies that Xi could dominate the political system.

From the perspective of policy direction, generally speaking, we believe there was no meaningful deviation from the current status quo. Xi reiterated that "Development is the party's first priority, the utmost mission" and that China's "principal problem" remains "unbalanced and inadequate development and the people's ever-growing needs for a better life". This suggests to us that economic development, beyond just credit-fueled GDP growth, would remain a focus over the next five years. Xi went on to say that, in his view, China needs both high-quality growth and a reasonable growth rate to achieve a goal of becoming a "middle-income developed country" by 2035. The IMF defines this as around USD 20,000 GDP per capita which implies a CAGR of 4.5-5.0% in the period from China's current GDP per capita of USD 12,900[18]. However, we believe this target will be difficult for China to achieve, considering non-productive investment growth can no longer sustain the economic growth, and a shift to a consumption-led growth model is necessary.

With regards to balancing public and private sectors, Xi reiterated that "both state-owned and private businesses are vital, and will continue to support the private sectors' growth". Opening-up was also reaffirmed as a crucial growth strategy. We believe that this implies regulations will be more benign going forward, and that major or sudden regulatory changes are less likely to occur.

Although Xi pointed out the importance of economic development in his speech, another fundamental concern we have is that his economic policies are increasingly characterised by his personal political aspirations and political ideologies, such as achieving "common prosperity" through reducing income inequality. This could show that his priority is politics over economic growth.

> **"China needs both high-quality growth and a reasonable growth rate to achieve a goal of becoming a "middle-income developed country" by 2035."**

That said, the Party Congress is not designed to address any current matters or policymaking but mainly to focus on leadership and high-level policy directions. In terms of near-term policies and long-term structural initiatives, these will be determined in the March National People's Congress ("NPC") and the subsequent two quarterly Politburo economic meetings (in April and July). The Central Economic Work Conference ("CEWC"), which is a forum where Chinese leaders map out the country's economic priorities including cyclical policies for the coming year, and mid December will offer a better glimpse of the national economic agenda and the new economic team. A more detailed economic structural reform blueprint will likely be rolled out in the Third Plenum of the 20th Party Congress in October or November 2023 (Exhibit 1).

Exhibit 1: Timeline for upcoming key policy events

Source: 20th Party Congress and Morgan Stanley Research, as at October 2022.

[17] Bloomberg, as of 28th October 2022.
[18] World Economic Outlook (October 2022) - GDP per capita, current prices (IMF, 2022).

China reopening from Covid

China's Zero-Covid policy has been a major overhang for the country's economic growth recovery, and the economic blowbacks from strict Covid controls have been apparent in various surveys of economic activities. This is in light of lower income growth, a sharp increase in youth unemployment, and rising difficulty in maintaining Zero-Covid amidst more transmissible variants (Exhibit 2).

Therefore, policy easing on other areas will have limited impact on stimulating the economy, if the stringent Covid containment approach remains in place. On 11th November, a day after the PSC meeting, the Chinese government announced "20 measures" to loosen its Covid control methods, including shortening the quarantine period and new regional Covid risk management, which signals its shift towards reopening. More importantly, in our view, this means the central government has started shifting the focus from Zero-Covid to the economy.

Although there is limited visibility on the exact reopening timeline, from our perspective, policymakers' reaffirmed commitment to economic development suggests that the Chinese government will continue to reassess the costs and benefits of Zero-Covid and adjust its strategy accordingly.

Given that China is now entering winter, and that the Omicron sub-variants BA.5 and BA.2.76 have now become endemic, we do not expect the government to scrap all Covid restrictions in the country before the second quarter of next year. We expect that the policy tools will continue to be loosened over time and adjustment will be gradual.

Fiscal stimulus

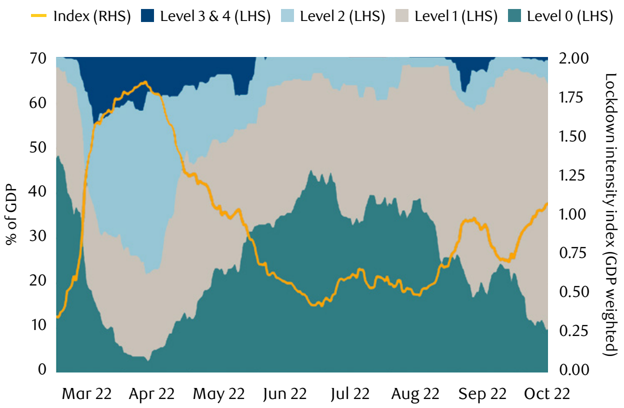
This year, China's overall fiscal policy has been expanding. Policymakers have rolled out a number of fiscal stimulus polices including RMB2.7 trillion tax cuts, a RMB800 billion policy bank loan quota, and the issuance of RMB600 billion new special financial bonds to support infrastructure investment.

Nevertheless, China's fiscal conditions have faced substantial challenges since April this year due to a sharp contraction of land sales, large-scale tax rebates and deferrals, and more spending on Covid controls (Exhibit 3). Fiscal distress is also unevenly distributed across regions within the country, with Covid-hit and property-reliant local governments bearing the largest burden. In order to fill the funding gap, policymakers have stepped up their policy support, including an RMB500 billion quota for additional local government special bond issuance to be fulfilled by end of October, and another RMB300 billion quota for policy bank credit support beyond the RMB300 billion quota unveiled by end of June.

While on the fiscal expenditure side, as Exhibit 3 highlights, fiscal expenditure growth has largely stabilised, which suggests China still has the near-term flexibility to expand fiscal spending on areas such as consumption and new infrastructure projects.

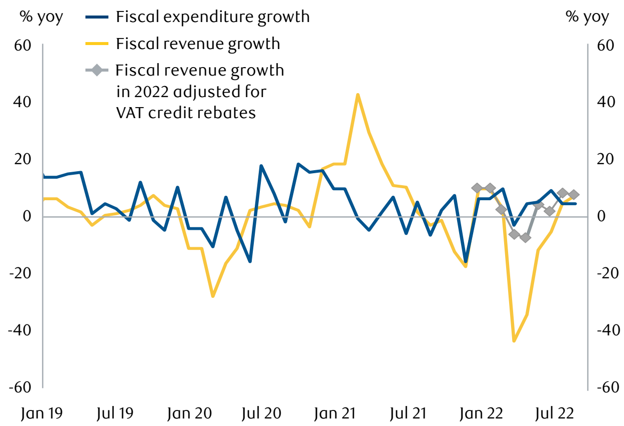
Given continuous downward growth pressure and weak demand outlook, we expect fiscal policies to remain positive in 2023. We do not expect to see a large fiscal stimulus package in the coming months, similar to the one in 2008, but an incremental fiscal easing to maintain government spending going forward.

Exhibit 2: Local lockdown intensity by share of GDP affected[19]



Source: Gavekal Research. Data as at October 2022.

Exhibit 3: Fiscal revenue and expenditure (monthly)



Source: Wind and Goldman Sachs Investment Research. Data as at October 2022.

[19] Top 100 cities = 70% GDP.

China real estate

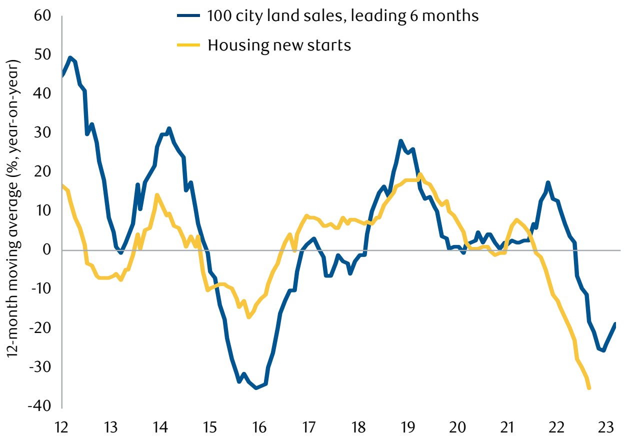
The property sector's downturn has yet to stabilise. Property sales have not recovered from the depressed level of April and the decline in new construction during the quarter only deepened (Exhibit 4).

The State Council has been working on restoring confidence in the industry, stepping up measures to revive demand and accelerate the completion of projects. A number of government policies have been announced in an attempt to stem the decline, including a policy bank lending program to resume stalled homebuilding projects, local government bailout funds, and lower mortgage rates. On the demand side, several local governments have also recently introduced more measures to encourage property sales, such as loosening home purchase restrictions, lowering local minimum mortgage rates and reducing down payment requirements.

However, the announcement of various supportive policies and easing on the demand side have yet to have a major impact on sentiment, and the real estate market remains very subdued with no meaningful pick-up in new homes sales. In September, housing new starts registered a contraction of 38% year-on-year in the first nine months (Exhibit 5). Overall, the central government's initiatives aim to prevent the credit crisis in the property market spreading to the broader economy and to try to build a more balanced and sustainable growth model.

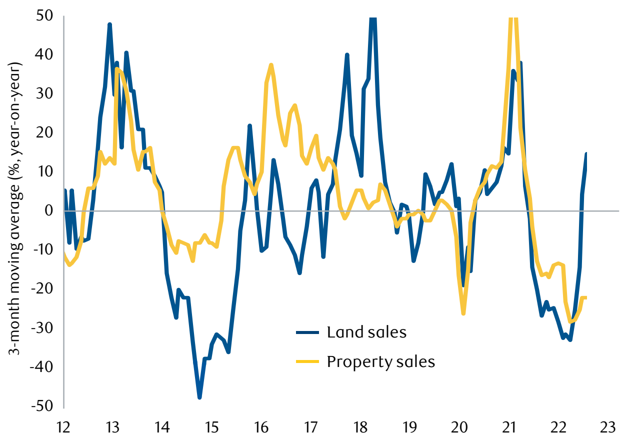
Going forward, we expect to see more continued incremental easing policies on property financing and purchase. In our view, instead of a rapid demand-stimulated recovery in the near term, what we are likely to see is gradual market adjustments on the demand-supply equilibrium in the property market.

Exhibit 4: Land market and housing new starts



Source: NBS, Wind and Macquarie Macro Strategy.
Data as at October 2022.

Exhibit 5: Land sales and housing market



Source: NBS, Wind and Macquarie Macro Strategy.
Data as at October 2022.

China internet

China internet sector's performance continued to be weak this year, affected by market sentiment and concerns on the sector's long-term growth trajectory due to weak discretionary spending. While headlines about delisting and regulations still affect price actions, in our view, the bulk of new regulation is behind us and the focus should be on the implementation of previously set policies (Exhibit 6). Under the new regulatory environment where forced exclusivity practices are not allowed, competition among internet platform companies has become more rational. The internet sector's growth therefore will moderate over the long term.

As such, we believe that bottom-up stock selection is more important than ever. Long-term earnings compounding potential for internet companies remain for those with diversified business model with exposure to underpenetrated verticals.

> **"China internet sector's performance continued to be weak this year, affected by market sentiment and concerns on the sector's long-term growth trajectory due to weak discretionary spending."**

Exhibit 6: Regulatory events on antitrust & prevention of disorderly capital expansion

- **January 2020**: The State Administration for Market Regulation (SAMR) published a draft amended Anti-Monopoly Law for public comment.
- **November 2020**: SAMR released draft guidelines for anti-monopoly laws, and tightened scrutiny of various monopolistic practices to tackle unfair competition in the internet industry, including price discrimination among consumers based on user data, bundled sales, predatory pricing, and restricting businesses to sell or offer services on rival platforms ("2-choose-1").
- **December 2020**: SAMR held an administrative guidance meeting on regulating the community group buying (CGB) businesses, which was attended by Alibaba, Tencent, JD, Meituan, Pinduoduo, and DiDi. The meeting requires internet platforms to strictly regulate the CGB business and abide by the "nine forbidden practices":
  - Must not abuse their independent pricing power through low price dumping, price collusion, bidding up prices, price fraud, etc.
  - Must not illegally reach or implement any form of monopoly agreement.
  - Must not abuse dominant market position, by means such as predatory pricing, etc.
  - Must not illegally implement concentration of business operators or exclude/restrict competition.
  - Must not carry out any unfair competitive acts.
  - Must not implement big data price discrimination.
  - Must not utilise technological means to damage the order of competition.
  - Must not collect and user consumers' personal information illegally.
  - Must not sell fake and shoddy products.
- **February 2021**: SAMR released the final version of China's new antitrust regulations targeting platform economies. Since then, SAMR has issued fines for various anti-monopoly practices to different companies.
- **April 2021**: SAMR imposed a USD2.8 billion fine to Alibaba for abusing market power. In the same month, SAMR launched an investigation into suspected monopolistic practices by Meituan, including exclusivity arrangements.

Source: State Administration for Market Regulation (SAMR), Morgan Stanley Research. Data as at September 2022.

Summary

Once again, China is at a crossroads. Ever since the country started to open up and reform its economy in 1978, the country's GDP growth has averaged 9% per year[20] but now its largest challenge is that the "middle-income trap" looms larger on the horizon. Productivity-enhancing reforms are therefore vital to reinvigorate the shift to more balanced high-quality growth, and to achieve the goal of becoming a "middle-income developed country" by 2035.

The country's economic future remains challenging given structural issues, including ageing demographics, declining productivity, a high debt level, and geopolitics. Looking into the next decade, growth is likely to be much lower compared to the previous decade, given that it will no longer be driven by credit-fueled investment. However in the near term, given the extremely negative sentiment and historically low valuation levels, we believe the risks are well understood and the market seems to be pricing them in. Chinese policymakers have a history of focusing on long-term growth. We therefore believe that they are likely to maintain that perspective and will continue to confront the structural growth slowdown the country is facing.

[20] World Bank, September 2022.

About the team

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Phil is a senior portfolio manager and head of the Emerging Markets Equity team at RBC GAM. He joined the firm in November 2009 from the asset management division of a large European bank, where he was head of global emerging markets. Phil was previously based at another global financial services firm in Zurich for four years as director and head of emerging markets and Asia in their multi asset class division. Prior to that, he managed global emerging markets, Asian, Latin American and US portfolios for nine years at a sovereign wealth fund. Phil started his career in the investment industry in 1992.

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Laurence is a portfolio manager and deputy head of the Emerging Markets Equity team at RBC GAM. Prior to joining the firm in 2013, she headed the emerging markets team of a leading U.K. asset manager. In this role, Laurence was responsible for managing Asian and global emerging market income strategies, and developing quantitative stock selection and environmental analysis models. She began her investment career in 1998 as a quantitative analyst at a major financial services company, where she supported European and global equity portfolio management by developing quantitative models to assist in the portfolio construction and security selection process.

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Angel is an analyst on the Emerging Markets Equity team at RBC GAM, working closely with portfolio managers to support both top-down and bottom-up research. Before joining the organisation in 2019, Angel completed a number of internships in Hong Kong, which included roles at a global assurance, tax, and consulting services firm, a U.S. management consulting firm, and a major Chinese firm offering investment banking and securities brokerage services.

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Will is an investment analyst on the Emerging Markets Equity team at RBC GAM. He assumed this role in 2022 after working on the team as a cover for the team's product specialist. Will joined RBC GAM in 2019 as a client services manager, where he was responsible for managing and developing relationships with existing institutional clients. Will was previously a client relations manager at a U.K. pension pool, where he looked after the pool's relationships with local authority clients. He had earlier worked as a senior analyst at an asset management research firm, where he worked closely with institutional investors and alternative funds.

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Dijana is a product specialist on the Emerging Markets Equity team at RBC GAM. Prior to joining the firm in 2018, she had worked as a vice president at an international bank, where she spent six years in the managed investments and investment marketing businesses, focusing on the positioning of investment capabilities and thought leadership. Dijana began her career in investment advisory in 2011.

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