China leads emerging market rebound

Maturing economies and institutions are helping emerging markets rebound from pandemic lows

By Adam Mayers

Emerging markets enjoyed a strong start to the year, but they were sent tumbling along with all world markets in mid-March.

The swoon sent the MSCI Emerging Markets Index down by 32 per cent. Since then, to the surprise of many, emerging markets have rebounded as strongly as developed world markets. The engine has been Chinese stocks which make up 41 per cent of the index.

"Amid the sell off, China was one of the few markets that really hung in there," says Chris Heakes, director, portfolio manager, exchange traded funds, with BMO Global Asset Management in Toronto. "It was seen to contain the virus and was the first to come out of it."

Specifically, he says the MSCI China Index is up by almost 23 per cent, in Canadian dollar terms, year to date as of mid-July. “That’s a strong return.”

Meanwhile, the MSCI Emerging Markets index is up by 1.8 per cent, in Canadian dollar terms, during the same period, outperforming the 6.1-per-cent decline in the S&P/TSX Composite Index.

Christine Tan is a portfolio manager and emerging market specialist at Sun Life Global Investments Inc., in Toronto.

While there are short term challenges for emerging markets, their response to the pandemic is a function of maturing economies and institutions, says Christine Tan, portfolio manager and emerging market specialist at Sun Life Global Investments Inc., in Toronto.

"Most of these economies are big enough now that there is a domestic cushion. They are no longer toddlers, but teenagers."

The lessons learned and changes made following the 2008 financial crisis are also helping these economies, Ms. Tan adds. Structural reforms strengthened central banks and beefed up stock market regulators. As a result, they are all better placed to withstand shocks and implement appropriate policies. That is one reason why the selloff has been less severe than in other crises.

The long-term forces that have been carrying emerging markets forward are also still at work. These include urbanization and young populations with rising incomes. High savings rates mean there is money to spend.

This offers opportunities for consumer goods, e-commerce, banks, insurance companies and blossoming investment services. Healthcare infrastructure is another area of growth, particularly in China, which is facing a demographic curve skewed to an aging population.

The U.S.-China trade war will continue to simmer. Some manufacturing will move back home and the sourcing of goods and supply chains will also change.

Both portfolio managers says a basket of stocks is a preferred way to spread risk and capture well capitalized emerging market players. Ms. Tan says some of the themes include the many forms of online retail and as well as such niches as online gaming.

"In North America, we started with Visa and Mastercard and are gradually moving to mobile payments," she says. "But we don't naturally adopt them because we started with credit cards.

"But in emerging countries, once you go outside cities, people might not have bank accounts. But they do have a mobile phone which they can use to easily transfer money or pay for things."

This means technology companies play a more diversified role. She notes that China's Alibaba Group Holdings Inc. (NYSE: BABA) has one of the biggest money market funds in the world, on the strength of its ecommerce business which has 1 billion users. By comparison, Paypal (NDQ: PYPL) has 325 million users and is predominantly a mobile payment business.

The coronavirus impact has also been uneven. China and South Korea were affected first and emerged first. Ms. Tan says their experience with other viruses and comfort with face masks has helped them cope with this outbreak.

"[This year] is going to be a significant reset," she says. "These economies shut down for two to three months and some don't have the same policy room that [we have] to stimulate."

Both Mr. Heakes' and Ms. Tan's firms offer emerging markets investment funds. The Sunlife Excel Emerging Markets Fund is an actively managed mutual fund that's sub advised by Schroder Investment Management North America Inc. The top sectors are technology, consumer discretionary and financials. It has $510 million in assets.

The BMO MSCI Emerging Markets Index (TSX: ZEM) is a passively managed ETF with $1.8 billion in assets, weighted by market capitalization. The top holdings by sector are technology, healthcare and communications.

Mr. Heakes expects volatility ahead as the US election campaign heats up."But that doesn't change those long-term drivers," he says. "There will be bumps in the road, but a bumpy road doesn't make it a bad one. Most investors should have some emerging markets in their portfolio."

This is an edited version of an article published in the Globe & Mail's Globe Advisor section of the Report on Business *July 21, 2020. It is reprinted from adammayers.com. Adam Mayers is a contributor to Globe Advisor and a contributing editor to Gordon Pape's Internet Wealth Builder investment newsletter.*