

PERSPECTIVE

2020 Outlook for Emerging Markets Equity Investing

December 18, 2019



Manraj Sekhon, CFA
Chief Investment Officer
Franklin Templeton Emerging Markets Equity

While US-China trade issues still haven't been resolved, there are reasons to be optimistic about the prospects for emerging markets in the coming year, according to Manraj Sekhon, chief investment officer, Franklin Templeton Emerging Markets Equity. He shares his outlook for 2020, and how technological innovation is leading to new investment opportunities in a number of countries.

Emerging markets are at a rare inflection point with multiple crosscurrents. A combination of the ultra-loose monetary policy hangover from the global financial crisis, a low global growth environment from weak manufacturing and industrial activity, the continued rise of the consumer, and the disruption and opportunities of the new economy have provided a heady mix.

Addressing Uncertainties

While market sentiment in 2019 was weighed down by easing growth concerns, emerging market growth is forecast by the International Monetary Fund to accelerate in 2020 and remain more than double that of developed markets.¹ Improving fiscal, economic and monetary policies and a renewed focus on structural reforms in many emerging markets has been gaining traction.

Supported by more conducive monetary policies in developed economies and easing inflationary pressures, central banks in emerging markets generally turned more dovish in 2019. We expect this trend to continue in 2020, as policymakers have greater flexibility in stimulating economic activity.

Although US-China trade tensions have de-escalated in the short term on rising expectations of a partial trade deal and plans for both countries to scale back tariffs, we expect the broader economic conflict to remain for some time. The impact from the trade conflict has not been limited to China.

While US imports from China over the last year declined US\$35 billion to US\$497 billion, China's imports from the United States decreased by more—US\$40 billion to US\$125 billion.² Therefore, we believe a comprehensive agreement remains in the best interests of both sides. The Trump administration will be acutely aware of this heading into an election year.

Opportunities in 2020

China's initiatives to strengthen and diversify its economy have been largely overshadowed by trade and slowing growth fears. The government's focus on economic restructuring and long-term sustainable growth has led to an acceleration in the implementation of structural reforms and widespread industry consolidation, as well as the development of local supply chains in the technology space to replace US sources.

China will be a frontrunner in the 5G arena and is expected to have some 600 million 5G subscribers by 2025, or about 40% of the forecasted 1.6 billion subscribers globally.³ Together with artificial intelligence (AI) and robotics, this will help drive growth in China's new economy as it strives to become less reliant on the United States. In our view, China will emerge stronger and more self-reliant with multiple pillars of economic support through this crisis.

Taiwan is seeing some spillover benefits from the trade war as its companies start onshoring some operations. Government incentives to attract operations back to Taiwan mean that this will have ripple effects on the domestic economy.

As one of the largest and fastest-growing markets for digital consumers, India is a market where disruptive technology is driving productivity and deflation more than generally expected, with value accruing to end-users. Key reforms—including the recent reduction in corporate tax rates, measures to improve the regulatory environment and monetary easing—will likely steady the economy.

In Brazil, optimism surrounding the government's economic agenda has resulted in a more favorable investment climate. While the country's economic recovery has been slower than expected, we believe government and central bank efforts are improving the country's longer-term growth potential. Inflation has remained under control, allowing the central bank to ease rates to record lows to stimulate the economy. Social security reform is key to stimulating investment and credit, which will help improve economic activity and can significantly reduce Brazil's fiscal deficit. A major privatization plan has also been announced, and tax and other structural reforms should improve the ease of doing business.

The New Emerging Market Landscape

The emerging market landscape continues to transform as policymakers focus on building resilience during times of stress. Emerging market economies are more diversified now—with domestic consumption and technology offering new drivers of growth—and are growing less reliant on low-cost manufacturing and commodities. Since the turn of the century, we have witnessed a significant increase in the trade value of high-tech goods being exported by emerging market countries.

We have also seen how companies are using innovation and technology to leapfrog and disrupt traditional business models. Areas such as e-commerce, digital banking and mobile computing will be fundamental drivers of emerging markets for years to come. Equally, fields such as AI, autonomous driving, robotics and the "Internet of Things" continue to attract investment, signaling strong longer-term prospects.

Staying the Course

Much noise and conflicting signals dominated 2019, which led many investors to limit their risk appetite and discount the long-term growth drivers in emerging markets. While some of these uncertainties may persist in the near term, we believe it is essential to stay the course. The markets are just beginning to realize opportunities from technology disruption and the transition of businesses away from traditional models. We believe the investment scope in the emerging world is wide and promising for investors who can overlook near-term volatility and invest for the longer term.

Important Legal Information

This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice. The views expressed are those of the investment manager(s) and the comments, opinions and analyses are rendered as of the publication date and may change without notice.

Data from third party sources may have been used in the preparation of this material and Franklin Templeton Investments ("FTI") has not independently verified, validated or audited such data. FTI accepts no liability whatsoever for any loss arising from use of this information and reliance upon the comments opinions and analyses in the material is at the sole discretion of the user.

The companies and case studies shown herein are used solely for illustrative purposes; any investment may or may not be currently held by any portfolio advised by Franklin Templeton Investments. The opinions are intended solely to provide insight into how securities are analyzed. The information provided is not a recommendation or individual investment advice for any particular security, strategy, or investment product and is not an indication of the trading intent of any Franklin Templeton managed portfolio. This is not a complete analysis of every material fact regarding any industry, security or investment and should not be viewed as an investment recommendation. This is intended to provide insight into the portfolio selection and research process. Factual statements are taken from sources considered reliable, but have not been independently verified for completeness or accuracy. These opinions may not be relied upon as investment advice or as an offer for any particular security.

Past performance does not guarantee future results.

Products, services and information may not be available in all jurisdictions and are offered outside the US by other FTI affiliates and/or their distributors as local laws and regulation permits. Please consult your own professional adviser or Franklin Templeton institutional contact for further information on availability of products and services in your jurisdiction.

CFA® and Chartered Financial Analyst® are trademarks owned by CFA Institute.

What Are the Risks?

All investments involve risks, including possible loss of principal. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments; investments in emerging markets involve heightened risks related to the same factors. To the extent a strategy focuses on particular countries, regions, industries, sectors or types of investment from time to time, it may be subject to greater risks of adverse developments in such areas of focus than a strategy that invests in a wider variety of countries, regions, industries, sectors or investments.

[1.](#) There is no assurance that any estimate, forecast or projection will be realized.

[2.](#) Sources: Customs General Administration PRC, U.S. Census Bureau, Bloomberg (annualized growth as of August 2019).

[3.](#) Source: GSMA Intelligence. As of October 2019. There is no assurance that any forecast, estimate or projection will be realized.