PERSPECTIVE

Emerging Markets End 2019 on a High Note

January 14, 2020

Emerging markets ended 2019 on a high note, but can the momentum continue? Our emerging markets equity team weighs in, highlighting the market news and events it has an eye on.

Three Things We're Thinking About Today

1. Optimism surrounding the government's economic agenda has resulted in a more favorable investment climate in **Brazil**. The Brazilian market outperformed its emerging market (EM) counterparts with a 14% gain over the fourth quarter 2019 and 27% increase for the year, both in US dollar terms. While the country's economic recovery has been slower than expected, 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. We believe social security reform is key to stimulating investment and credit, which should help improve economic activity and 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.

2. Trade and slowing growth fears have largely overshadowed **China's** initiatives to strengthen and diversify its economy. 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 fifth-generation wireless technology arena (5G) and is expected to have some 600 million 5G subscribers by 2025, or about 40% of the forecasted 1.6 billion subscribers globally.[1] Together with artificial intelligence (AI) and robotics, this should 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 from this challenging period stronger and more self-reliant, with multiple pillars of economic support.

3. **Kuwait** is undergoing a multi-year effort to introduce fiscal reforms, increase investment and diversify away from oil dependence. In December, index provider MSCI stated that Kuwait met all the necessary requirements for reclassification to EM status and will be added to the MSCI Emerging Markets Index in May 2020 with an estimated weight of 0.69%. With substantial reserves, low levels of debt and a stable banking sector, we think Kuwait stands out among its peers. Add to this a budget breakeven oil price of just US$49 a barrel for 2019—the lowest by some margin in the region—and a AA[2] credit rating, we believe Kuwait could be considered an attractive investment destination in the Middle East. Despite trading at a premium to its EM peers, valuations in Kuwait remain reasonable, in our view.

Outlook

Much market noise and conflicting signals dominated 2019. 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.

The International Monetary Fund forecasts EM growth will accelerate in 2020 and remain more than double that of developed markets.[3] Improving fiscal, economic and monetary policies and a renewed focus on structural reforms in many EMs has been gaining traction. The EM landscape continues to transform. EM 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.

Although US-China trade tensions have de-escalated in the short term on news of a partial trade deal and both countries scaling 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. A comprehensive agreement therefore remains in the best interests of both sides. US President Donald Trump’s administration will be acutely aware of this heading into an election year in 2020.

Emerging Markets Key Trends and Developments

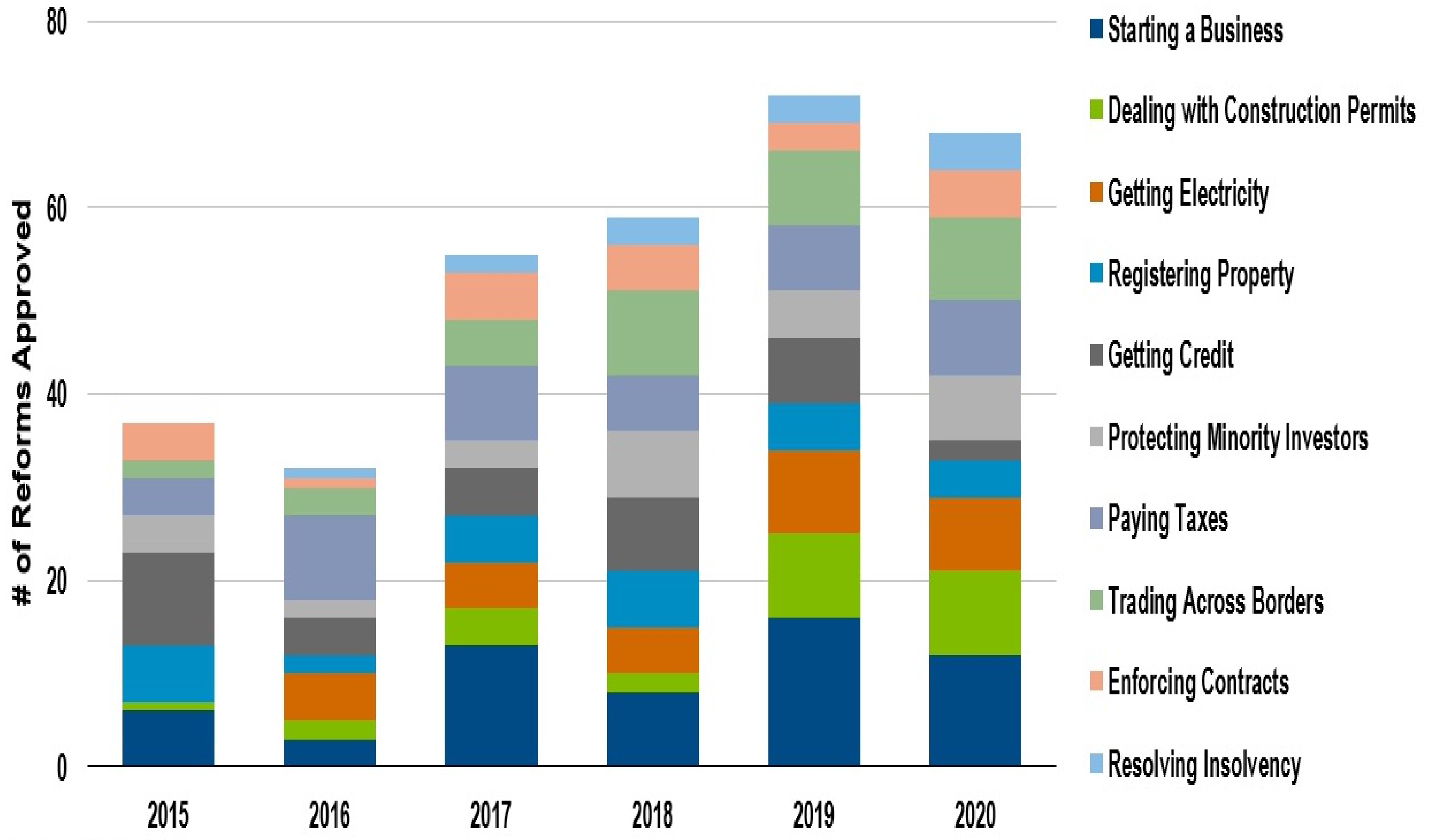
EM equities advanced over the fourth quarter of 2019 and pulled ahead of developed market stocks. Global monetary easing and the imminent signing of a partial US-China trade deal cheered investors, even as political tensions rose in parts of the emerging world. The MSCI Emerging Markets Index returned 11.9%, while the MSCI World Index returned 8.7%, both in US dollars.[4]

Emerging Markets: Policy Improvements

Improving Reform Trend

World Bank: Ease of Doing Business Reforms Across EMs

2015–2020



For illustrative purposes only.

Source: "Doing Business 2020;" comparing business regulation for domestic firms in 190 economies; 2019 is for period between June 2, 2017, and May 1 2018, The index measures reforms in 11 areas: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, resolving insolvency and labor market regulation. Emerging markets are based on the MSCI EM Index. Indexes are unmanaged and one cannot invest in an index. They do not include fees, expenses or sales charges.

The Most Important Moves in Emerging Markets in the Fourth Quarter of 2019

Asian stocks climbed, with markets in Taiwan, China and South Korea outperforming. China and the United States reached consensus on a "phase one" trade deal, including the suspension of new tariffs and scaling back of certain duties. Improved global trade sentiment helped lift trade-sensitive indexes in Taiwan and South Korea. Meanwhile, Thailand's stock market edged down amid a weaker outlook for the domestic economy.

Latin American equities advanced. Brazil's stock market rallied as the central bank raised its economic growth forecasts and trimmed its key interest rate to a record low. We expect lower interest rates in Brazil to drive a reallocation of assets from cash to equities as investors seek better returns. In Mexico, stocks finished the quarter higher supported by gains in December as the central bank loosened monetary policy and a US-Mexico-Canada trade pact drew nearer to completion.

In the Europe, Middle East and Africa region, Russian equities delivered sturdy returns. The Bank of Russia's interest-rate cuts and a rebound in crude oil prices buoyed the market. Strong retail sales and real wage growth further supported sentiment. South Africa's market rose as firmer gold prices lifted materials stocks. A stronger rand also boosted equity returns. Equity markets in the UAE, Turkey, Qatar and Saudi Arabia, however, lagged.

Scroll over the map to view comments on the countries indicated and our sentiment.
Green = positive, Red = negative, Blue = neutral

The graphic reflects the views of Franklin Templeton Emerging Markets Equity regarding each region and are updated on a quarterly basis. All viewpoints reflect solely the views and opinions of Franklin Templeton Emerging Markets Equity. Not representative of an actual account or portfolio.

Regional Outlook
As of December 31, 2019

ISO Code	Country	Sentiment Score	Opinion
CN	China	0.5	Economic conditions show signs of stabilization following the November purchasing man stabilize growth rather than re-stimulate the economy. Moreover, trade tensions have ea to be signed in mid-January. Interest rate cuts can be expected in 2020, should conditior half of the fourth quarter as the market digested an easing in trade tensions and stable e trade talks progress well or the government's supportive measures prove to be strong er
IN	India	0.5	Long-term fundamentals including under-penetration, formalization of the economy and inflation and improving corporate earnings are offset by high valuations and slowing eco
KR	South Korea	0.5	Macro indicators remain sound. However, concerns about government regulations are gr
PK	Pakistan	0	Uncertainty remains, with concerns including a structurally weak economy with high trac
TW	Taiwan	0.5	The US-China trade dispute brings uncertainty to the market. The restrictions on Huawei are engaged. However, 5G development is on track. FY20 growth outlook should be bette valuations. As a result, range trading is expected.
PL	Poland	0.5	The ESI (Economic Sentiment Indicator) rose to 100.9 in November, from a recent low of Sentiment in the industry sector, however, deteriorated over the month.
CZ	Czech Republic	0.5	The ESI (Economic Sentiment Indicator) edged up 0.2 points to 102.4 in November, after rising confidence in the retail sector.
HU	Hungary	0.5	Economic sentiment improved for the second consecutive month in November (to 111.8 sectors were the main drivers of November's pick-up. If sustained, the recovery in the ES
RU	Russia	1	In a stable oil price/ruble environment, domestic names should benefit due to earnings r stable with the next presidential election scheduled for 2024. However, macro risks rema possibility of additional US/EU sanctions..
BR	Brazil	1	The new government's emphasis on implementing ambitious economic reforms should p environment for companies. Record-low interest rates should continue driving domestic

MX	Mexico	0.5	It is difficult to assess if the glass is half full or half empty with President Andrés Manuel macroeconomic stability, his autocratic ruling method leaves the door open to a lack of c populism and rationality.
QA	Qatar	0.5	Risks include slowing economic growth, political conflict and deadlock, and continued we
KW	Kuwait	0.5	The MSCI upgrade to EM status should support the equity market until May 2020. Kuwait defensive. A persistent risk is political deadlock, which often leads to slower fiscal reform
SA	Saudi Arabia	0.5	The EM Index inclusion upgrade story is behind us now. The focus has returned to fundar performance.
AE	United Arab Emirates	0.5	Within the region, the UAE is least dependent on oil revenues. Fiscal reforms such as the however, needs to be monitored closely.
EG	Egypt	0.5	Egypt has made a committed step toward economic reforms. It is witnessing receding in
KE	Kenya	0.5	Our outlook remains neutral to positive. The IMF expects around 6% GDP growth for 201
NG	Nigeria	0	Equity valuations remain cheap. Expectations for reforms from President Buhari, howeve the substantial claims against telecom company MTN.
ZA	South Africa	0	The outlook remains muted and dependent on the government. 2020 could be tougher t

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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.

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1. Source: GSMA Intelligence. As of October 2019. There is no assurance that any forecast, estimate or projection will be realized.

2. Moody's Definition of AA Credit Rating: Obligations rated AA are judged to be of high quality and are subject to very low credit risk.

3. Source: International Monetary Fund World Economic Outlook database, October 2019. There is no assurance that any estimate, forecast or projection will be realized.

4. Source: MSCI. The MSCI Emerging Markets Index captures large- and mid-cap representation across 24 emerging-market countries. The MSCI World Index captures large- and mid-cap performance across 23 developed markets. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or guarantee of future results. MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com.