

Turning Tides in Emerging Markets

| *India, Indonesia, and Brazil are making waves*

18 Feb 2025

GQG Research

Key Takeaways

- > Following a prolonged bear market, emerging markets appear to be experiencing a resurgence, fueled by improved economic policies, healthier banking sectors, reduced leverage, and robust corporate earnings
- > We believe countries like India, Indonesia, and Brazil offer compelling investment opportunities, with companies offering strong earnings growth and attractive valuations
- > Emerging markets have historically delivered strong long-term returns and can provide diversification benefits for investors

A NEW WAVE OF GROWTH IN EMERGING MARKETS

After yet another year of US equity outperformance, many investors seem to be losing faith in emerging market equities. This is not surprising to us.

Having invested in both developed and emerging markets across many market cycles, we understand the current market sentiment, especially in light of the prolonged bear market in emerging markets. It resembles what we observed in the US during the financial crisis or in the energy sector during the COVID pandemic.

However, we believe the tide in emerging markets has already begun to turn. During the painful 2010s, emerging markets quietly improved their economic policies and deleveraged, which eventually led to a recovery in corporate earnings and bond markets.

Over the past few years, countries like India, Indonesia, and Brazil have delivered earnings growth comparable to the S&P 500,¹ and emerging market bonds have consistently outperformed those in developed markets.² With this in mind, we are seeing new momentum within this asset class.

THE UNITED STATES, THE ORIGINAL EMERGING MARKET

Although it often gets lost in history, “US exceptionalism” was not always the norm. There was a time when British investors looked down upon the US as an unruly former colony plagued by civil war, bank runs, sharp currency fluctuations, poor corporate governance, and rampant corruption.

*According to historian Charles Geisst, “[the United States’s] image became so tarnished that the British dubbed their former subjects ‘a nation of swindlers’...the popularity of American investments had sunk to a low not seen since the War of 1812...it would take some extraordinary salesmanship to convince substantial foreign investors to continue investing as in the past,” as noted in his book *Wall Street: From its Beginnings to the Fall of Enron*.*

In other words, the US was the original emerging market. As we know now, any British investor who refused to invest in such a volatile and messy country would likely see things differently today.

Fast forward to today, we believe many investors are making a similar mistake by deeming emerging markets uninvestable. To be clear, we are not suggesting that today’s emerging markets will become tomorrow’s superpower. In fact, most—if not all—will remain emerging markets for the rest of our careers.

It took America well over a century after independence to become a developed market, whereas most emerging markets today only achieved independence in recent decades. However, today’s emerging markets are simply too big to ignore, accounting for 50% of global GDP in aggregate in 2024 and showing improving fundamentals.³ In fact, India’s \$5 trillion equity market⁴ is already bigger than most G7 countries and has produced more multibaggers than any other major market recently.⁵

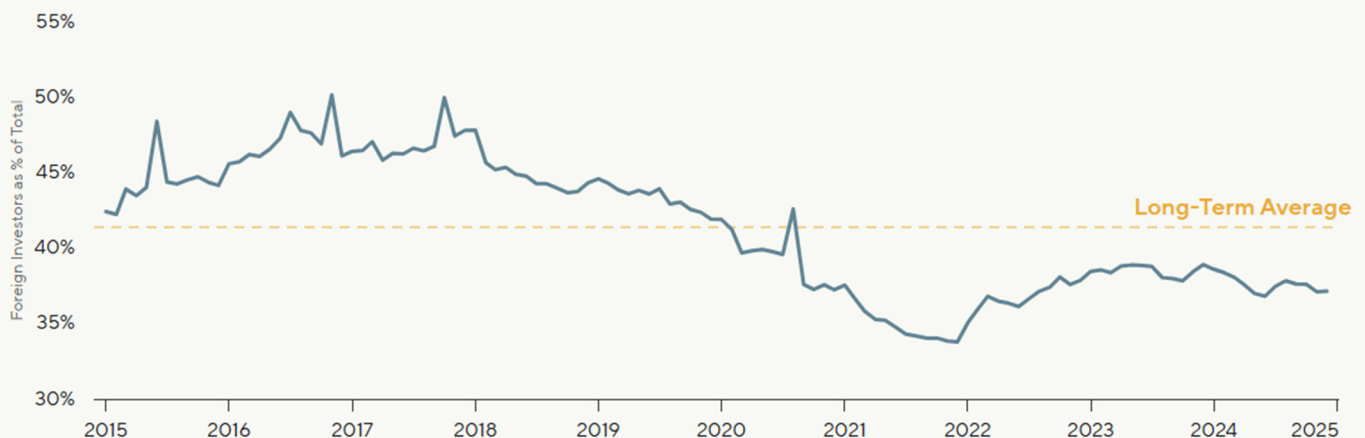
EVERY ASSET CLASS EXPERIENCES BOOM-BUST CYCLES

Contrary to popular perception, the emerging market asset class has delivered strong long-term returns. Since the MSCI Emerging Market (EM) index was launched in 1988, it has compounded at 9% annually, compared to 11% for the S&P 500. Analyzing trailing returns at the bottom of a cycle can also understate this reality.

Foreign investment in emerging markets has waned over recent years due to negative sentiment toward the asset class. As an example, foreign investor ownership as a percentage of total market capitalization in Brazilian equities has remained below the ten-year average since mid-2020. While other investors may view these assets as out of favor, we see an opportunity.

Foreign Investor Sentiment Shift

Foreign Investment as a Percentage of Total Brazilian Market Capitalization



Source: B3 S.A., Brazil Stock Exchange. Goldman Sachs. Data from 1 January 2015 through 1 December 2024.

Many investors questioned the need to invest in the US after the 2008 financial crisis, as the S&P 500 emerged from its worst decade ever. As students of history, we believe every asset class experiences boom-bust cycles. Since the inception of the MSCI EM index nearly 40 years ago, emerging markets have faced four distinct cycles.

Long-Term Relative Returns

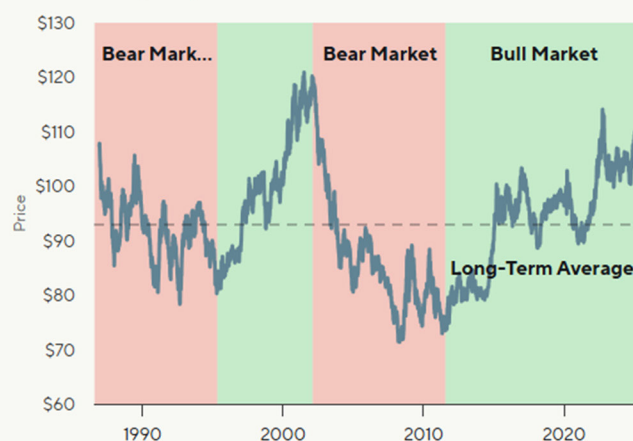
MSCI Emerging Markets/S&P 500



Source: Bloomberg. Data from 1 January 1988 through 24 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

US Dollar Tends to Be Mean Reverting Over Time

Dollar Index (DXY)



Source: Bloomberg. Data from 9 December 1986 through 20 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

A HISTORY OF EMERGING MARKET CYCLES

The 1988–1994 Bull Market

With the collapse of the Soviet Union, a wave of emerging markets began transitioning from socialism to capitalism. For example, India faced a massive economic crisis in 1991 that forced the government to adopt pro-business policies. Similarly, China's Deng Xiaoping gave his famous southern tour in 1992, which accelerated the country's shift toward capitalism.

Emerging markets also began deregulating their banking systems. Mexico rapidly privatized many banks in the early 1990s. Bank credit expanded rapidly as interest rates were liberalized, credit controls and lending restrictions were removed, and mandatory liquidity ratios were abolished.

Malaysia was a key driver of the emerging market bull market under Prime Minister Mahathir's leadership.⁶ With consistent 8% GDP growth, Malaysia soon became an investor darling, constituting approximately 35% of the MSCI EM index. In fact, Kuala Lumpur occasionally boasted of higher trading volumes than New York City at the time.⁷

The 1994–2001 Bear Market

The good times for emerging markets did not last. A series of poor economic decisions, excessive leverage, dependence on foreign capital, and political unrest resulted in a painful bear market. Emerging markets began collapsing like dominos in the late 1990s, due to one crisis after another, such as the Asian financial crisis, Russian debt default, and Mexican tequila crisis.⁸

Indonesia's currency collapsed over 95%, the Suharto regime was overthrown after decades in power, and the entire banking sector essentially evaporated.⁹ In a prelude to the global financial crisis a decade later, Indonesia's largest bank, Bank Central Asia, faced a liquidity crunch in 1998 and was nationalized.

Amid this turmoil, the US technology sector became the envy of the world with rapid innovation and accelerating earnings growth. Like NVIDIA with the AI revolution today, the famed Wintel partnership (Microsoft + Intel) spearheaded the 1990s PC revolution. As a result, investors pivoted from emerging markets to the US as the belief in American exceptionalism became unshakeable.

"For the third year running, 2001 was supposed to be the year the dollar finally took a fall against the euro and other currencies...foreigners retain a nearly unshakeable faith in the US economy. They keep investing money in America, confident that returns there will be higher than most other places and risks lower," read the *Wall Street Journal* at the time.¹⁰

The 2001–2010 Bull Market

The good times for the US did not last. Eventually, the technology bubble burst, rising fiscal and trade deficits hit the dollar, and a painful financial crisis resulted in a lost decade for US equities. In contrast, emerging markets improved with better economic policies and earnings growth.

While the banking sector nearly collapsed in the developed world, emerging market banks thrived with 20% to 30% annual loan growth. Indonesia's banking sector accelerated sharply after being rebuilt from scratch during the Asian financial crisis. While Malaysia drove the previous bull market, this time it was China.¹¹

The narrative quickly changed from US exceptionalism to superior emerging market economic growth. A 2009 *Wall Street Journal* quote summarized the sentiment around the US at the time: "In nearly 200 years of recorded stock-market history, no calendar decade has seen such a dismal performance as the 2000s...the last 10 years have been a nightmare, really poor for US stocks...investors would have been better off investing in pretty much anything else, from bonds to gold or even just stuffing money under a mattress."¹²

The 2010–Present Bear Market

The good times for emerging markets did not last. Like the late 1990s, poor economic and business decisions resulted in a lost decade for most emerging markets, while the US technology sector boomed. As with Malaysia in the prior cycle, the biggest index constituent (China) experienced a structural slowdown that dragged down the benchmark.

The early 2000s credit boom resulted in a painful hangover for emerging market banks. For example, the Indian government bailed out its state-owned banks in 2018 as non-performing loans surged.¹³ At one point, Brazil's development bank (BNDES) became bigger than even the World Bank.¹⁴ To add insult to injury, Morgan Stanley coined the phrase "Fragile 5" in 2013 to refer to the South African rand, Indian rupee, Indonesian rupiah, Turkish lira, and Brazilian real.¹⁵

During this period, US earnings benefited from low interest rates in multiple ways—providing cheap funding to technology companies that could then pursue capital expenditures, boosting consumer sentiment and purchasing power. Once again, the US technology sector became the envy of the world as it drove one innovation after another: cloud computing, e-commerce, social media, smartphones, and artificial intelligence.

However, as interest rates begin to normalize across most of the world, this will likely become a headwind for earnings growth in the US. In contrast, emerging market business models are designed to accommodate a high-interest-rate environment. As one Brazilian CEO remarked, "US banks disappear when interest rates increase from 0% to 5%, whereas Brazilian banks make even more money when local rates increase to 15%."¹⁶

EARNINGS ARE LIKE GRAVITY

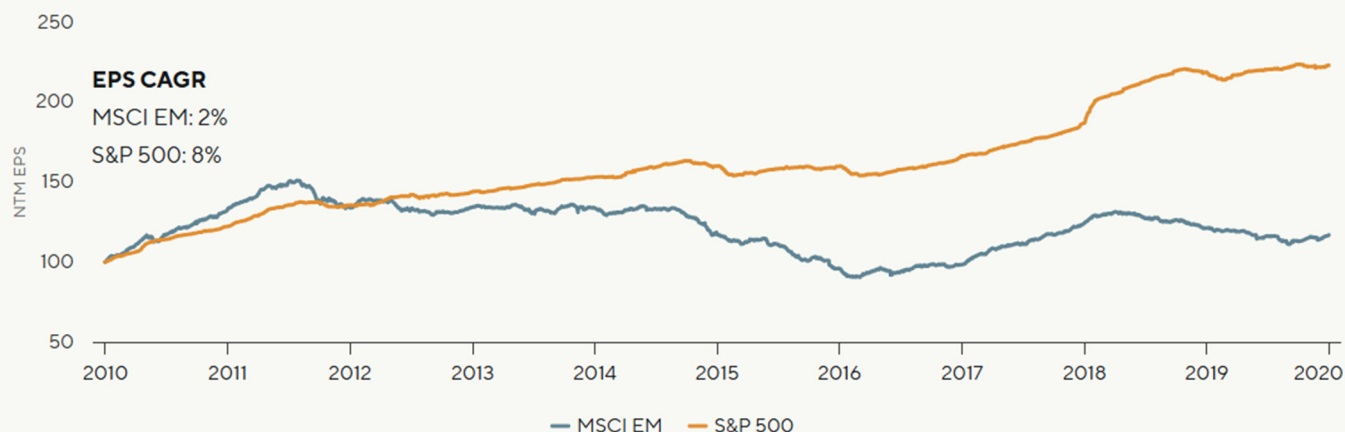
So why invest in emerging markets now? Superior GDP growth, favorable demographics, or relative valuations by themselves are not compelling enough reasons. China's mediocre long-term equity returns are a great case study showing that these variables alone are not sufficient to drive performance.

Instead, our North Star is corporate earnings. In our office is a sign that reads, "Earnings are like gravity," because we believe stock prices follow earnings over the long term. Thus, we are turning positive on emerging markets primarily due to the improving earnings outlook.

In our opinion, the single biggest driver behind the S&P 500's massive outperformance over the past decade has been earnings growth. After minimal earnings growth in the 2000s, the S&P 500's earnings accelerated to an 8% CAGR in the 2010s, largely driven by the technology sector. In contrast, the MSCI EM's earnings were basically flat during this time.

MSCI EM Index vs. S&P 500 Index

Consensus Next Twelve Months Earnings Per Share

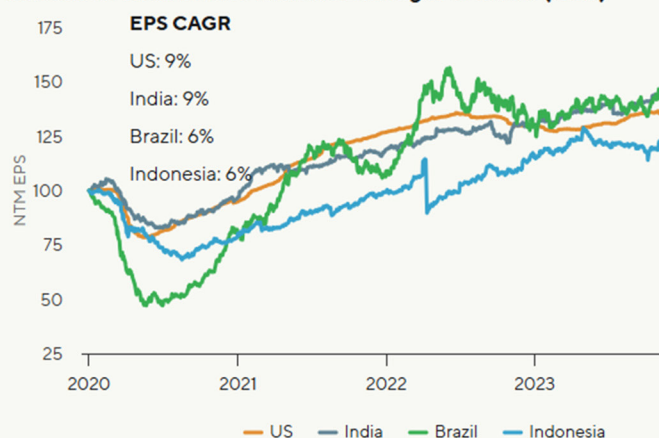


Source: Bloomberg. Data from 31 December 2009 through 31 December 2019. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

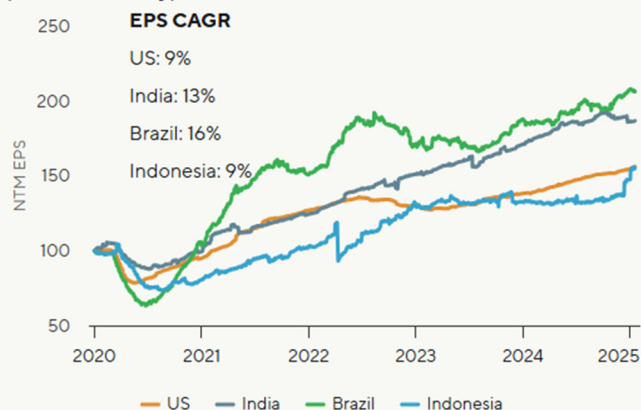
However, earnings have started to recover for emerging markets in both local currency and US dollar terms. We will focus on three of our favorites—India, Indonesia, and Brazil—but these are by no means the only markets we are excited about. Since January 2020, these three countries have delivered earnings growth comparable to the S&P 500, despite having minimal technology exposure.

US, Brazil, Indonesia, and India Earnings Per Share (In US Dollars and Local Currency)

Consensus Next Twelve Months Earnings Per Share (USD)



Consensus Next Twelve Months Earnings Per Share (Local Currency)



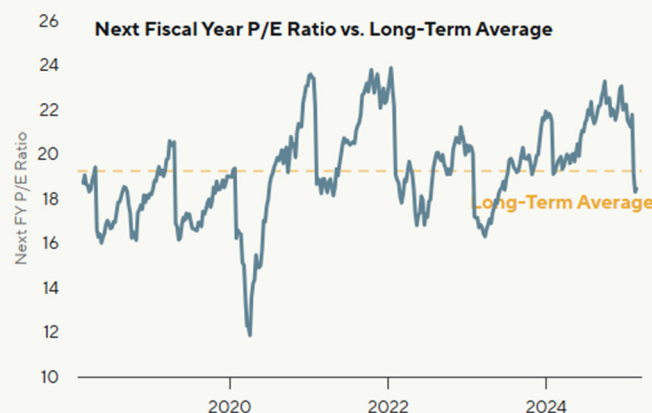
Source: Bloomberg. Data from 1 January 2020 through 19 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

Zooming out a bit as it relates to these favorites, it is worth pointing out that none of these three have seen any multiple expansion. In fact, each trade *more cheaply* today than they did seven years ago. Versus their valuations on a next fiscal year P/E basis, the MSCI Brazil and MSCI Indonesia indexes are approximately 45% and 32% cheaper, respectively.¹

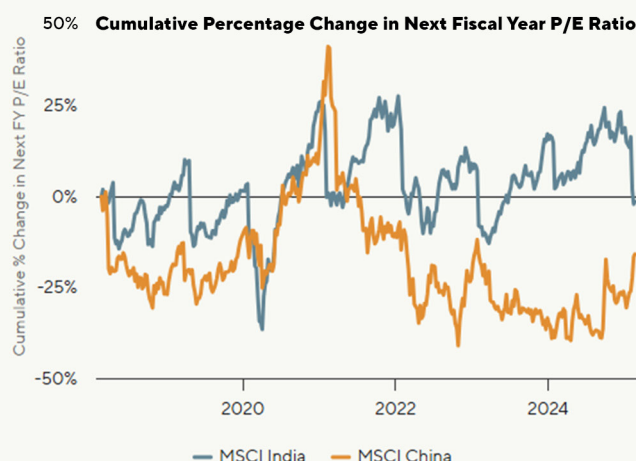
Even in the case of India versus China—a comparison investors often like to draw as an allocation rivalry—valuation differentials between the two regions look much closer to their historical norms, despite India demonstrating meaningfully faster corporate earnings growth (in US dollar terms) compared to China. Over the seven-year period between February 2018 to February 2025, the MSCI India index has seen its 12-month earnings per share rise approximately 60% while the MSCI China index has contracted by approximately 10%.¹

India vs. China

MSCI India



MSCI India vs. MSCI China



Source: Bloomberg. Data from 23 February 2018 through 20 February 2025. You cannot invest directly in an index. PAST PERFORMANCE NOT INDICATIVE OF FUTURE RESULTS.

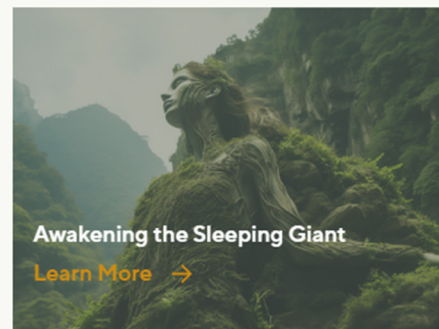
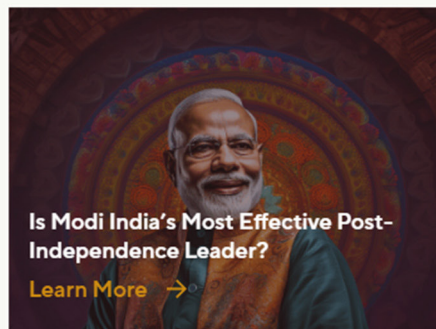
DRIVERS OF THE EARNINGS INFLECTION IN EMERGING MARKETS

Improving Economic Policies

Good economic times often lead to bad economic policies, and vice versa. In our opinion, it is only in the darkest times that politicians are willing to make the unpopular but necessary decisions required to stabilize an economy, such as slashing spending. The early 2000s bull market led to poor economic policies, including increased spending, trade deficits, excessive leverage, corruption, and government intervention, to name a few.

However, the sharp slowdown in emerging markets during the 2010s resulted in pro-business leaders taking office: Narendra Modi in India, Michel Temer and Jair Bolsonaro in Brazil, and Joko Widodo in Indonesia. We have discussed their economic policies at length in prior GQG research papers.

GQG Research Papers



One Indian CEO remarked how “the Indian government went from slapping red tape on businesses to rolling out a red carpet for them” under the Modi administration.¹⁷ Unlike in the developed world, trade deficits and inflation in emerging markets have improved dramatically over the past few years.

India, Indonesia, and Brazil each reduced their trade deficits from 4% to 5% of GDP to 1% to 2% over the past decade, whereas the US went in the opposite direction. Similarly, inflation improved from roughly 10% at its peak to mid-single digits.

In contrast, the developed world seems to be making the same economic mistakes the emerging world made in the 2000s. As of this writing, the US has a 6% fiscal deficit despite a booming economy, a 4% trade deficit, and a 120% debt-to-GDP ratio.¹⁸

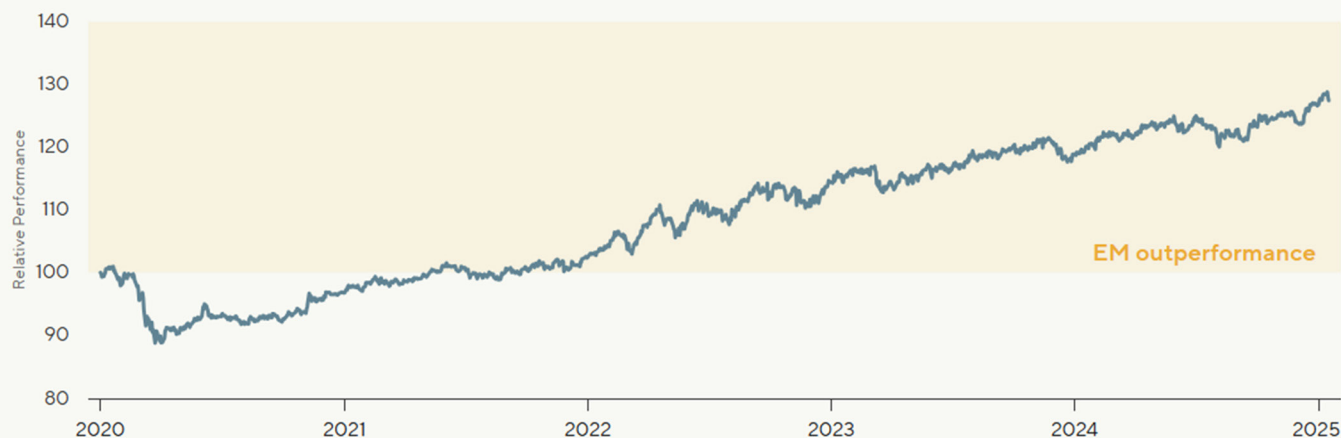
Europe is in an even tougher situation given its stagnating economy, stifling regulatory environment, and political turmoil. Bond markets have been sending a clear message with emerging market sovereign bonds consistently outperforming developed market bonds in recent years.

Stronger Banking Systems

Today, most emerging market banking systems are in solid shape, in our view, as loan growth has improved, and corporate balance sheets have been cleaned up. It is also important to remember that banks have an outsized impact on emerging market equity markets as they are typically the largest public stocks in each country. The financial sector makes up approximately 25% of the MSCI EM benchmark and accounts for three of the five biggest public companies in Indonesia.

Emerging Market vs. Developed Market Sovereign Bonds

Bloomberg EM Local Government Bond Index/Bloomberg G7 Total Return Index



Source: Jefferies. Data from 1 January 2020 through 16 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

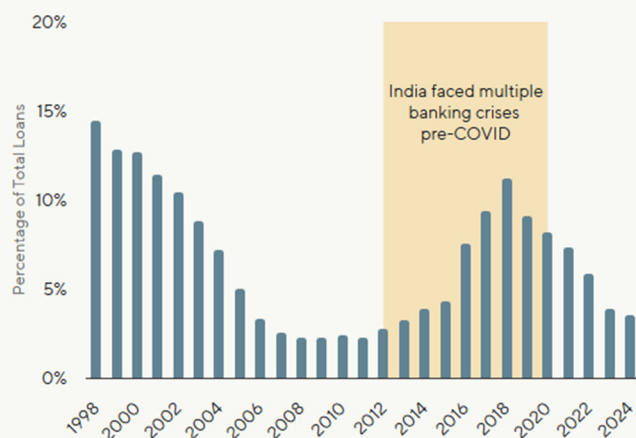
The developed world faced a banking crisis in 2008, but India, Indonesia, and Brazil experienced one nearly a decade later. Buoyed by the early 2000s bull market, local corporations of these emerging market countries took on excessive debt and paid the price once growth slowed down.

As a result, Brazil's two biggest companies, Petrobras and Vale, nearly went bankrupt in the mid-2010s. This had a cascading impact on these countries' banking systems, particularly the state-owned banks. Non-performing loans surged, liquidity dried up, and banks sharply curtailed lending.

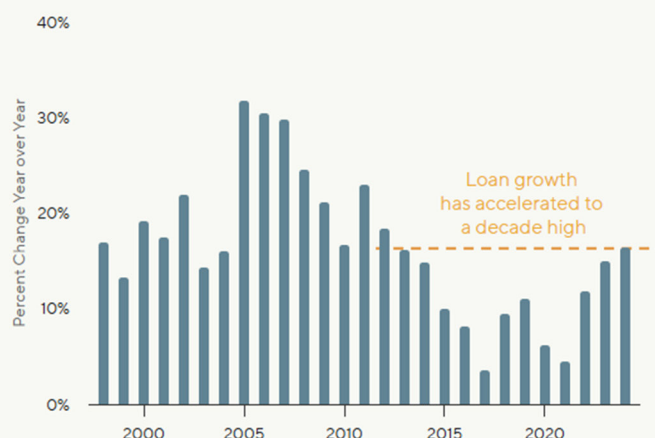
Meanwhile, India's non-performing loans crossed 10% of GDP in 2018.¹ Any economy would struggle in this environment, as credit has a multiplier impact across sectors such as housing, autos, and infrastructure.

India Credit Growth and Non-Performing Loans

Gross Non-Performing Loans



Loan Growth



Source: Bloomberg. Data from 1 January 2020 through 19 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS.

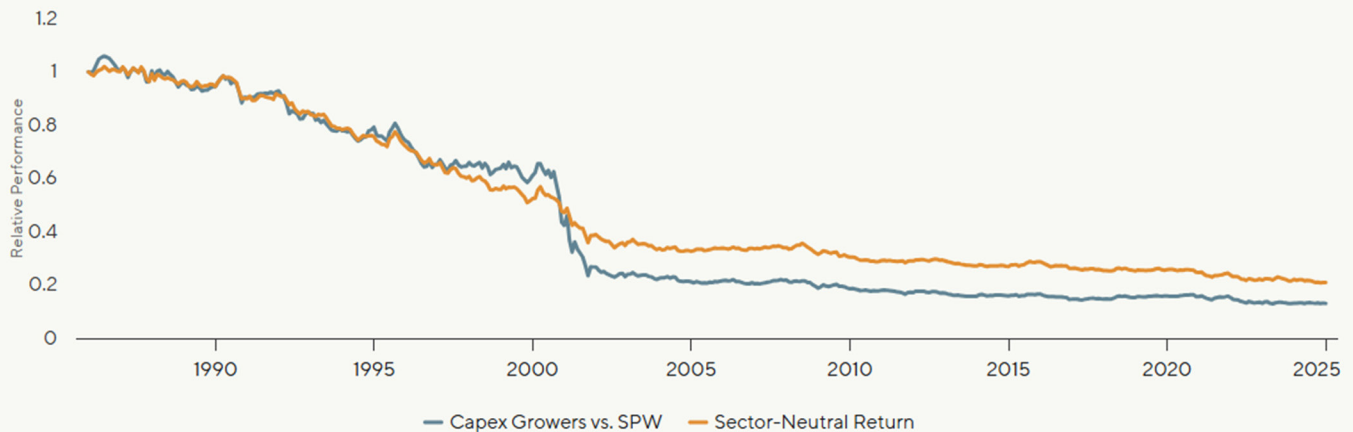
EMERGING MARKETS PROVIDE TRUE DIVERSIFICATION

While we remain positive on the US given its plethora of high-quality companies, we are starting to see clouds on the horizon. Most notably, we believe the massive AI-driven capital expenditure surge in the technology sector could soon start weighing on S&P 500 earnings growth.

Prior innovations, such as railroads, electricity, shale, and telecom, also went through similar capital expenditure cycles, and they did not end well. Rising fiscal and trade deficits could also eventually negatively impact the dollar, similar to the early 2000s.

Relative Performance of Capital Expenditure Growers

Top Decile in Last Twelve Months CapEx Year over Year vs. Equal-Weighted S&P 500



Source: Bank of America. Data from 31 December 1985 through 31 December 2024. You cannot invest directly in an index. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

From a diversification perspective, we also believe investors should consider how much of their overall portfolio is likely to behave similarly to US technology. This may be a much larger portion of their portfolio than they realize. Emerging markets offer an idiosyncratic return profile and have historically moved in cycles opposite to those of the S&P 500, as discussed above.

RIDING THE WAVE IN EMERGING MARKETS

On a bottom-up basis, we are finding many attractive investment opportunities in emerging markets.

India

India's Sensex is one of the only major indexes that has matched the S&P 500's earnings growth over the long term. Over the past 20 years, both the US and India have delivered approximately 7% US dollar earnings per share (EPS) growth.¹ Like the US, India offers a large addressable market, a stable democracy with rule of law, and a dynamic private sector. Unlike its Asian peers, India's consumption-driven economy helps insulate the country from global volatility.

Given the country's size and growth outlook, we believe India could be the main driver of emerging market earnings over the next cycle, like Malaysia and China played previously. In particular, we are very excited about the country's infrastructure sector, which has grown earnings by over mid-teens annually.

The main pushback with India is valuation. However, after the recent correction, the Sensex now trades at its pre-COVID multiple of 20 times EPS, despite better earnings growth.



Indonesia

Indonesia offers many of the same characteristics as India (pro-business government and stable democracy) that have resulted in attractive long-term returns. Since the beginning of the 21st century, Indonesia has delivered 9% annualized US dollar returns compared to India's 10% and the US's 8%.¹

Relative to India, we think Indonesia will likely see slower earnings growth but higher dividends. For example, the country's index currently offers an attractive 5% dividend yield. We are positive on the big banks, which could deliver low-double-digit earnings growth and a 20% return on equity.



Brazil

Brazil faced its equivalent of the Great Depression during the 2010s but is well on the path to recovery, with its economy consistently surprising to the upside post-COVID. Furthermore, Brazil's returns largely come from dividends with the country's Ibovespa index now yielding 7%. We continue to see investment opportunity in Petrobras, Brazil's oil major, which operates some of the highest quality oil reserves in the world and offers a mid-teens dividend yield.

The main downside in Brazil is the Lula administration's fiscal spending, in our opinion. However, we are being paid to wait, given the robust dividends and elections less than two years away. Additionally, we believe a company like Petrobras is relatively immune, given its significant dollar revenue and dividends, which help plug the country's fiscal gap.



United Arab Emirates (UAE)

Similar to Asia in a previous cycle, the Middle East is transforming into a new frontier for investing as the region opens its economy to foreign investment, implements pro-business reforms, and rapidly attracts expatriates. The UAE is copying the Singaporean playbook and transforming into a global financial hub.

Most UAE companies offer a mid-single-digit dividend yield with high-single-digit earnings growth in a stable currency. The property sector is likely to be one of the biggest beneficiaries from the country's transformation, in our view, and could see high-teens earnings growth.



ACTIVE MANAGEMENT IS KEY TO NAVIGATING EMERGING MARKETS

Understanding cycles is a critical component of navigating financial markets over the long run. Both the US and emerging markets have experienced lost decades in the past, and it is a mistake to simply extrapolate recent performance. Economic policies, corporate earnings, and bond markets have already inflected positively in many emerging markets.

Active management is crucial here, as each country has different growth drivers and risks. We are finding many attractive investment opportunities in areas such as Indian infrastructure, Indonesian banks, Brazilian oil, and UAE property.

While not guaranteed, history suggests that an improving relative earnings outlook could also drive higher multiples and a weaker dollar, which would be a triple tailwind for emerging markets. There are many potential risks to monitor, such as the implications of Trump 2.0, but we believe investors with a longer-term perspective should consider adding emerging markets as part of a diversified portfolio.

END NOTES

¹Bloomberg.

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⁷Briand, Remy and Fachinotti, Giacomo. "Emerging Markets: A 20-Year Perspective." MSCI Barra. 2008.

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⁹Breuer, Luis E, Guajardo, Jaime, and Kinda, Tidiane. "Realizing Indonesia's Economic Potential". International Monetary Fund. 1 August 2018.

¹⁰Sesit, Michael R. "Foreigners' Confidence in U.S. Economy Keeps Dollar Strong Against Currencies." *The Wall Street Journal*. 6 July 2001.

¹¹Morgan Stanley.

¹²Lauricella, Tom. "Investors Hope the '10s Beat the '00s". *The Wall Street Journal*. 20 December 2009.

¹³Antony, Anto, and Singh, Siddhartha. "Fitch Sees \$14 Billion Bank Bailout Easing India Downgrade Woes." *Bloomberg*. 24 January 2018.

¹⁴Rapoza, Kenneth. "Brazil's New 'World Bank'-Sized Crisis". *Forbes*. 31 May 2017.

¹⁵Yueh, Linda. "The Fragile Five". *BBC*. 26 September 2013.

¹⁶According to GQG Research.

¹⁷According to GQG Research.

¹⁸"United States Government Debt: % of GDP". CEIC Data. 1969-2024.

DEFINITIONS

Multibagger is an equity stock that gave a return of more than 100%.

Earnings Per Share (EPS) is a measure of a company's profitability, calculated by dividing quarterly or annual income (minus dividends) by the number of outstanding stock shares.

Non-performing loans, or "NPLs," are bank loans that are subject to late repayment or are unlikely to be repaid by the borrower.

Compound Annual Growth Rate (CAGR) is a measure of an investment's annual growth rate over a period of time.

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INFORMATION ABOUT INDEXES

The **MSCI Emerging Markets Index** captures large and mid cap representation across 24 Emerging Markets (EM) countries*. With 1252 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **MSCI Brazil Index** is designed to measure the performance of the large and mid cap segments of the Brazilian market. With 49 constituents, the index covers about 85% of the Brazilian equity universe.

The **MSCI Indonesia Index** is designed to measure the performance of the large and mid cap segments of the Indonesian market. With 20 constituents, the index covers about 85% of the Indonesian equity universe.

The **MSCI India Index** is designed to measure the performance of the large and mid cap segments of the Indian market. With 156 constituents, the index covers approximately 85% of the Indian equity universe.

The **MSCI China Index** captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 581 constituents, the index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization.

The **S&P 500® Index** is a widely used stock market index that can serve as barometer of US stock market performance, particularly with respect to larger capitalization stocks. It is a market-weighted index of stocks of 500 leading companies in leading industries and represents a significant portion of the market value of all stocks publicly traded in the United States.

The **BOVESPA Index**, commonly known as IBOVESPA, is the primary performance indicator of stocks traded on the Sao Paulo Stock, Mercantile & Futures Exchange (Brazil). It is not possible to invest directly in an index.

The **Sensex Index** is a free-float market-weighted stock market index of 30 well-established and financially sound companies listed on the Bombay Stock Exchange (India). It is not possible to invest directly in an index.

The **US Dollar Index (DXY)** is a measure of the value of the United States Dollar relative to a basket of foreign currencies. The basket of currencies consists of the Euro, Swiss Franc, Japanese Yen, Canadian Dollar, British Pound, and Swedish Krona.

The **Bloomberg EM Local Currency Government Index** measures the performance of fixed-rate, local currency emerging market treasury issuers. Securities must have at least one year remaining until final maturity.

The **Bloomberg G7 Fixed Income Index** is a rules-based index that measures the risk and return of fixed income assets in the G7 countries. The G7 countries are Canada, France, Germany, Italy, Japan, the United States, and the United Kingdom.

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