EMERGING WEALTH UPDATE

Week Ending April 9, 2021

GW&K INVESTMENT MANAGEMENT

Market Performance

For the week ended April 9, 2021, the MSCI Emerging Markets (EM) Index declined -0.6%, led by a continued selloff in growth stocks. The MSCI EM Growth Index declined -0.7% compared to flat performance for the MSCI EM Value Index. For the year-to-date period, the MSCI EM Index increased by 3.4% led by an increase of 4.9% in EM Value, and a 2.0% return for EM Growth. China was among the weakest countries this week with a decline of -2.2%. India and Russia were also among the weakest countries for the week with returns of -1.4% and -3.6%, respectively. For the year-to-date period, the strongest countries were in the Middle East driven by higher energy prices, with Chile and South Africa driven by prospects for sustainable commodity prices, and Taiwan supported by demand for technology. China, after strong performance in 2020, is a notable underperforming country as growth, above 8%, will likely moderate as the year progresses as other countries around the world recover from a more challenging 2020. The strongest sectors for the year-to-date period were Materials and Information Technology with increases of 12.1% and 8.2%, respectively. Consumer Discretionary and Health Care were the weakest sectors year-to-date with returns of -2.8% and -2.6%, respectively. The shift to the Value investment style in Emerging Markets is consistent with the sectors and countries outperforming year-to-date. We are in the midst of a very strong global economic recovery with GDP estimates increasing over the past several weeks. This recovery favors cyclically oriented countries and sectors which were hit hardest in 2020 in the short run.

The tendency towards rising consumption in Emerging Markets, particularly in China and India, remains a powerful secular trend. The temporary shift to cyclical stocks and the value investment style presents an opportunity for investors to position in high quality growth stocks which have corrected from their highs for attractive returns over the next five to ten years.

Return to India

It was only in the early 1990's that foreign investors were allowed to buy Indian stocks. At the time, the market cap was only $90 billion and GDP was only $260 billion. Since then, GDP has grown at 6.5% annually and now stands at $2.9 trillion. The market cap has grown at 13% annually to $2.7 trillion.* While India is well behind China in per capita income, over the next ten years, India is expected to reach the upper middle income country threshold of $4,300. Real GDP is expected to grow at 6% and nominal growth is expected to exceed 10%. There are several factors driving greater growth prospects for India: Government reforms put in place over the past ten years including the largest biometric identification system in the world, the doubling in the number of bank accounts resulting in 80% of Indians having a bank account, and demonetization and sales tax reform. These policies, while controversial when implemented, were clear signs the government was taking steps to transition from an informal to a formal economy and minimize friction. India has a young population and a low per capita income making it the ideal country to capitalize on companies diversifying their manufacturing supply chains away from China. The government has embarked on a large infrastructure upgrade program while at the same time reducing the tax rate to among the lowest in Asia to capitalize on this opportunity. Government officials have already met with over a thousand developed market companies in an effort to attract new manufacturing facilities. Building a manufacturing hub will take time, but some analysts forecast that manufacturing as a percentage of GDP will rise from 15% to 20% by 2030.

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But… Indian Equities are Expensive

The prospects for growth in India are among the highest of any country in the world. Profits as a percentage of GDP are set to rise from a low level historically. As India transforms from cash to digital economy, the stage is set for a limited number of companies to experience well above average growth rate relative to global peers. We have an over weighted position in India in some of the best positioned franchises in the country. Yes, on the surface, the Indian stock market is expensive and this gives investors pause, but the more you know about the story, the prospects for growth, the demographics, and the limited number of companies with exceptional positions in the market, the more you will come to understand the investment opportunity for one of the most attractive markets in the world for long-term appreciation.

*Source: *Primer: A Look at India's History and the Path Ahead,* Morgan Stanley, India Economics and Equity Strategy, April 4, 2021

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