2022 Emerging Markets Mid-Year Outlook:

Navigating Opportunities and Headwinds

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[1]As of March 31, 2022.
[2]Investments and Pensions Europe, 2021.

Executive Summary

Despite the -16.3% year-to-date (YTD) performance,[1] we are impressed with the resilience of Emerging Market (EM) equities. In any year with the S&P down 19.9%, the US Dollar (USD) up 7.2%,[2] Russian assets marked to zero, and China locking down its two largest cities, one would rightly cover their eyes before looking at EM performance. Impressively, though, EM has outperformed various asset classes this year due to (1) prudent central bank policies, (2) higher commodity prices, and (3) recognition of the disconnect between EM and Developed Market (DM) valuations.

EM equities remain significantly under-owned. The MSCI ACWI+FM benchmark has an 11.7% allocation to EM, but global equity investors still carry only 4.9% exposure.[3] This under-weight positioning combined with discounted valuations, higher growth rates, and higher dividends sets up an interesting catch-up opportunity. Now we need a catalyst.

Chinese equities fell 21.6% in 2021, as measured by the MSCI China Index. The majority of this slowdown was self-inflicted, and we believe the pendulum has swung too far. While the rest of the world is tightening monetary policy and easing fiscal stimulus, China is the only major central bank in the world cutting interest rates. The Chinese government is also extending credit, picking up spending, and reducing regulatory rhetoric. This is creating a significant amount of pent-up demand and the coil has continued to tighten as China pushes its zero-Covid policy. The question regarding a rebound is not if, but when. At some point, China will likely fully reopen based on a combination of successful new vaccines, testing measures, and the eventual move to endemic status. At this time, the combination of rebounding demand from China and global commodity supply restrictions could create a significant opportunity for EM assets. We continue to focus on finding dynamic companies with quality management teams and unique business models that can offer sustainable returns well above their cost of capital.

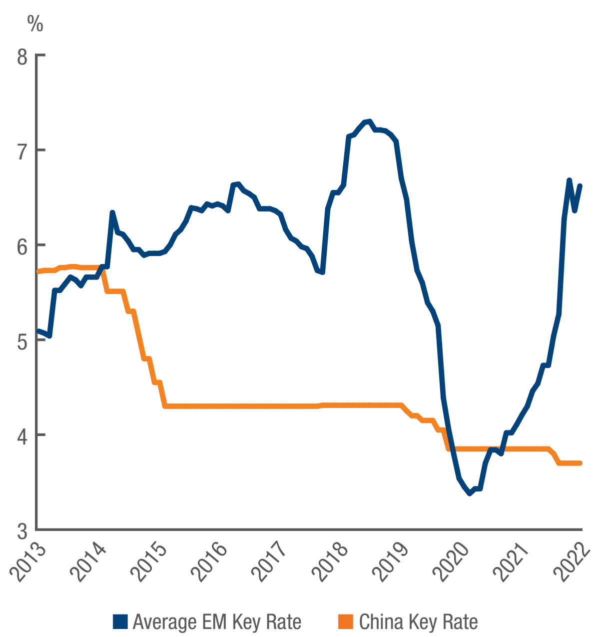
[1] Bloomberg, as of 6/15/2022.
[2] Bloomberg, as of 6/15/2022; USD represented by the DXY Index.
[3] Source: EPFR Global, Thomson Reuters Datastream, HSBC calculations, Mirae Asset, data as of 2/28/22.

Key Events & Trends

China Growth and Common Prosperity

Last year was supposed to be favorable for EM, particularly as emerging Asia was set to benefit from being first-in, first-out of Covid-19, improving commodity prices, and a weak USD outlook from a dovish US Federal Reserve (Fed). Instead, Chinese equities declined more than 21%, driven by a combination of regulatory crackdowns across technology and education companies, government-driven weakness in the commercial property sector, new Covid-19 variants with China's strict zero-Covid policy, and a slowdown in pandemic-driven fiscal stimulus. However, China has recently shown signs of commitment to near term economic growth. Since the Fed pivot in November, China has been the only major global central bank that is not raising interest rates this year to support short-term growth. Since the beginning of the year, the People's Bank of China (PBOC) has cut its policy rate by 10 basis points and its reserve requirement ratio (RRR) by 25 basis points.[4] As other markets tighten, we expect China to focus more on domestic demand growth, which includes investment and consumption. The country also has fiscal room for support as its fiscal deficit has improved to -4.7% of GDP (from -6.2% in 2020), while simultaneously pausing regulatory measures that slowed growth in the second half of 2021. For example, the PBOC announced that loans used to fund low-cost public rental homes would no longer be subject to regulatory curbs on property lending.

Interest Rates Across EM



Source: Bloomberg, as of 5/31/2022

Longer term, we are optimistic around China's pivot to sustainable, independent, and consumption-driven growth. This comes in the form of a policy called "Common Prosperity" and aims to double China's middle class over the next decade. Common Prosperity addresses challenges such as inequality, lack of competitiveness, and pollution, while updating regulations to reflect changes from technological advances. In turn, the government has shifted its focus from quantitative growth to qualitative growth with the goal of building a strong foundation for future long-term economic success.

We are not only encouraged by China's near and long term economic policies, but also by its structural opportunity. China is the second-largest spender on research & development behind the US, and plans to increase spending by more than 7% annually between 2021-25.[5] The share of the population with a university degree exceeded 15% in 2020, nearly double from a decade ago,[6] while investment flows toward innovations in higher-end manufacturing and green projects. When combined with a rapidly expanding middle class, we believe that China should be able to sustain around 5% GDP growth in the coming years.

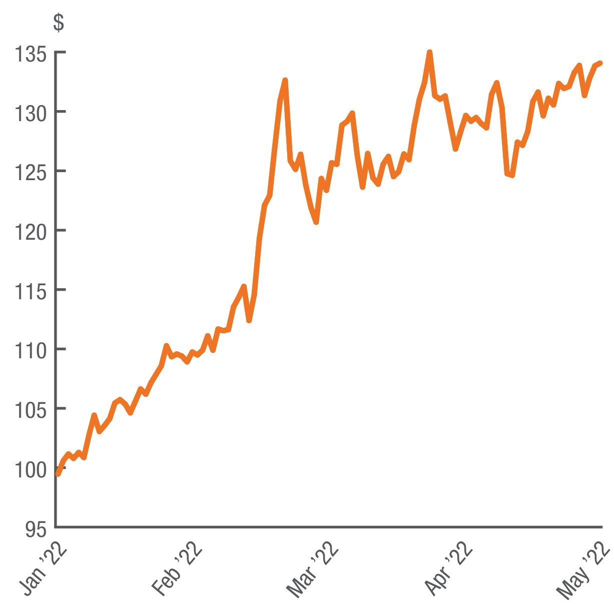
Ukraine, Russia, and Commodities

Commodity markets had a robust start to 2022 and Russia's invasion of Ukraine provided a further shock, spiking the price of energy, metals and food. Russia's aggression on Ukraine led to sanctions from most Western nations. The supply shock further exasperated global inflation, forcing global central banks to accelerate their monetary policy tightening plans. Various drivers will determine the outlook for commodities in the second half of the year. Firstly, the general uncertainty and lingering effects from the war in Ukraine. The largest impact from a continuation of the conflict will be on the oil and gas industry since Russia accounts for 12% and 17% of global production.[7] Wheat is also a major export from the region, with both Ukraine and Russia accounting for nearly 30% of global supply.[8] Secondly, China's zero-Covid policy and subsequent lockdowns have dampened demand for many commodities. Therefore, in the second half of 2022, we expect prices to correlate with lockdowns in China along with a resurgence in demand once the government lifts mobility restrictions. Finally, supply-side concerns and uncertainty will likely continue to provide tailwinds for commodity prices. OPEC+ remains committed to its current 400,000

[4] PBOC, as of May 26, 2022.
[5] China's 14th Five-Year Plan (2021-2025).
[6] China's Ministry of Education, CEIC and BOFIT.
[7] BP, Statistical Review of World Energy 2021- Russia.
[8] Reuters, March 2022.

barrels per day monthly increase plan, while supply chain bottlenecks, labor strikes, protests and other idiosyncratic factors also provide upside risks to commodity prices. We expect commodity prices to remain elevated for a longer period than initially expected, putting pressure on global central banks, corporates and consumers, but also providing tailwinds for many commodity-driven economies in Latin America, Africa, and the Middle East.

Bloomberg Commodity Index



Source: Bloomberg, as of 5/31/2022.

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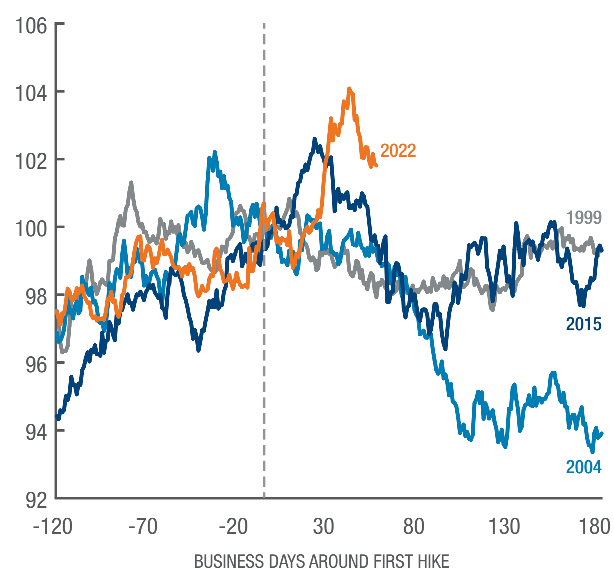
Interest Rates and the US Dollar

The combination of various years of easy monetary policy, recent waves of fiscal stimulus, Covid-induced supply chain challenges, and the current commodity environment has led to a spike in global inflation. This spike has led the Fed to pivot into a rate hiking cycle that has led to significant market uncertainty. Higher US interest rates create two challenges for EM equities. First, overall EM equities offer a structural story based on promises of high growth and maturation over a multi-year period. This means high duration. When interest rates move up, investors must revisit their models with higher costs of capital — meaning they are discounting their future cash flows at higher rates, which leads to lower valuations. Second, higher US rates tend to attract flows, which creates a stronger USD environment. Historically, EM equities have displayed an inverse relationship with the dollar (gaining roughly 4% for every 1% downwards move of the USD). This correlation is due to both (1) the inverse relationship between the USD and commodity prices, and 2) EM countries and the companies within them having historically funded their growth prospects with USD debt. Though the USD has strengthened 7.2% YTD,[9] we've seen that it is normal for the currency to appreciate in the months leading up to the start of a Fed hiking cycle, but weaken in the months after.

USD Index Around the Last Four Fed Liftoffs
Lift-off Date = 100



Source: J.P. Morgan.

[9] Bloomberg, as of 6/15/2022.

Prospects of a weaker USD could signal healthier balance sheets, lower interest expenses, and higher earnings revisions — all positives for EM equities and similar to what we have seen in past cycles. In fact, looking back at data between 1999 and 2022, EM equities have outperformed, on average, by 11% and 10%, respectively, the following 6 and 12 months after initial Fed rate hikes.

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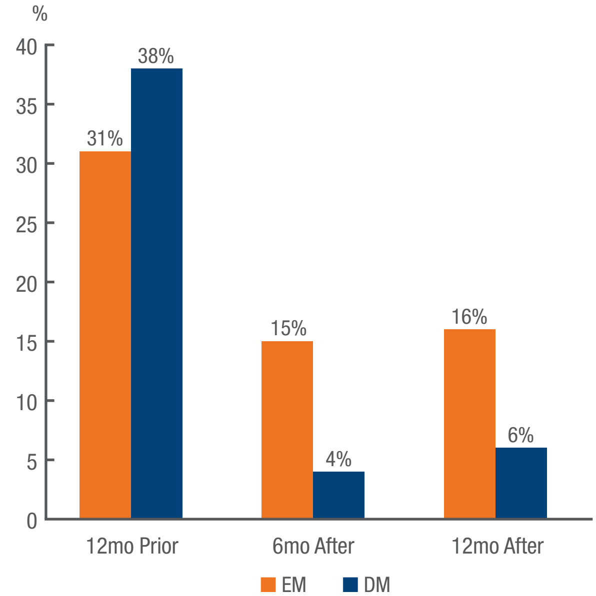
Rate Hikes and EM Impact

Before and After Initial Federal Reserve Rate Hikes 1999–2022



Source: Bloomberg.

Headwinds and Tailwinds Across the Emerging Markets

Headwinds

- COVID-19
- An inflation-led spike in US treasury yields
- Escalating tension between the US, China, and/or Russia

Tailwinds

- A weaker US dollar
- A slowdown in inflation
- Stable commodity prices

Asia

General Overview

While global growth is showing signs of deceleration, the impact across Asia appears to be more modest. India's GDP, for example, is forecast to grow 8.2% in 2022 — a slight step down from 8.9% in 2021 but significantly higher than the 2022 global growth projection of 3.6%.[10] ASEAN countries are also expected to see relatively healthy economic activity, supported by an accelerated reopening and strong trade flows. China's recovery pathway, however, remains uncertain against the backdrop of its zero-Covid approach. The Chinese government's regulatory reset is now largely behind us, and we expect to see more measures for policy easing going forward.

Emerging Asia

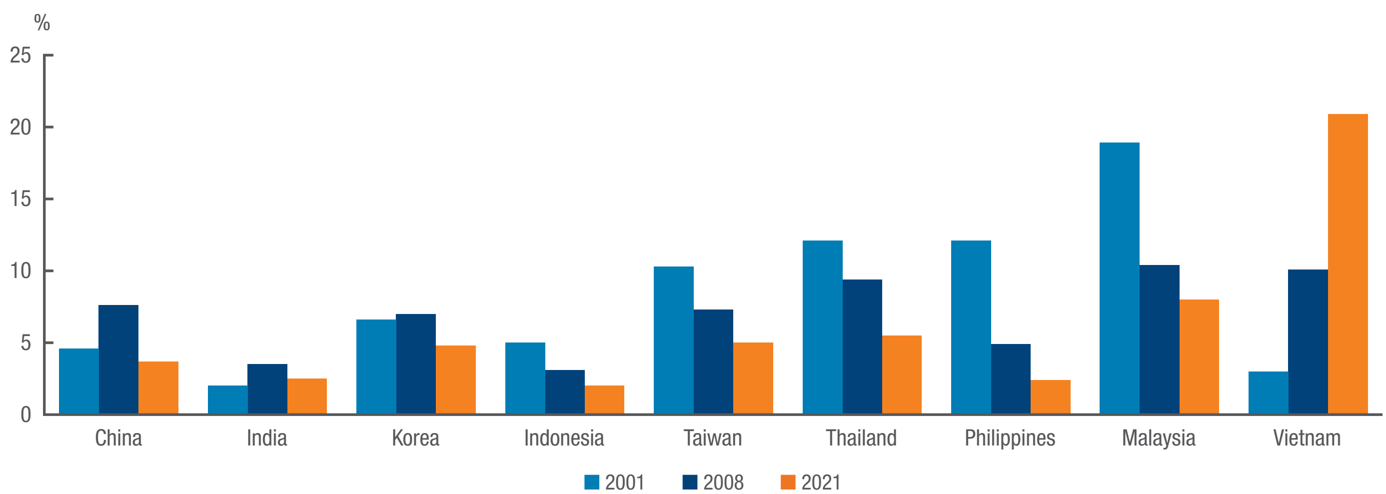
We are cautiously optimistic about emerging Asian equities for the remainder of the year. At a global level, the Fed is normalising its policy rate and reducing its balance sheet, while the ongoing conflict in Ukraine exacerbates stagflation risk. For the US in particular, the sharp increase in input costs, higher wage inflation, and decadal high-profit margins put pressure on US equities. We believe the Fed is taking a pragmatic approach to expeditiously reach the neutral rate to try and bring demand down closer to supply, and will reassess economic conditions thereafter.

[10] International Monetary Fund, April 2022.

A global growth slowdown will be inevitable through this process, but we don't believe it will lead to a deep recession. While strong household and corporate balance sheets may prolong the Fed's inflation fight, it should also prevent a deep and extended slowdown. Elsewhere, we've also seen signs of an investment cycle pick up across the US and Asia as corporations look to boost capacity to alleviate shortages of critical materials and products.

For emerging Asian markets, the China-led market correction accounts for much of the slowdown and valuation contraction. However, the bearish sentiment and low investor positioning in the first half of the year could now be at a turning point as a post-Covid reopening will reignite consumer sentiment across the region. Over the last ten years, emerging Asian economies have reduced their dependence on the US and Europe while increasing domestic consumption and intra-region trade.[11] In addition, unlike the US, wage-driven inflationary pressures are much less of an issue in the region, though pressure has been felt from rising commodity prices. However, in recent weeks we've seen a sharp correction in most commodities, with oil being the exception.[12] As US demand for goods begins to normalise, we expect commodity price pressure to ease towards the end of the year, mitigating market concerns of input cost pressures in emerging Asia.

Emerging Asia Countries: Exports to North America as % of GDP



Source: Trademap, IMF WEO, Credit Suisse, May 2022.

China

China has undergone a difficult first half of the year. The growth slump, which started with the regulatory reset last year, was exacerbated by China's zero-Covid approach. Since the beginning of March this year, over 40 cities across China have undergone some form of mobility restrictions, with Shanghai suffering the most severe and extended lockdown.[13] In total, these cities account for over 25% of China's GDP and 20% of its population.[14] The pandemic remains the most pressing threat to China's economic recovery, especially to consumer spending and business confidence.

While the worst of the Omicron outbreak is likely over, concerns over subsequent lockdowns under the zero-Covid policy remain. To prevent another city-wide disruption, China has now double-downed on mass testing, with a network of lab testing booths set up across the country's largest and most economically vital cities, and invoking individuals to obtain regular testing.[15] We expect China to continue with this approach at least until the National Party Congress in October/November this year, providing more time for its elderly population to ramp up vaccination rates.

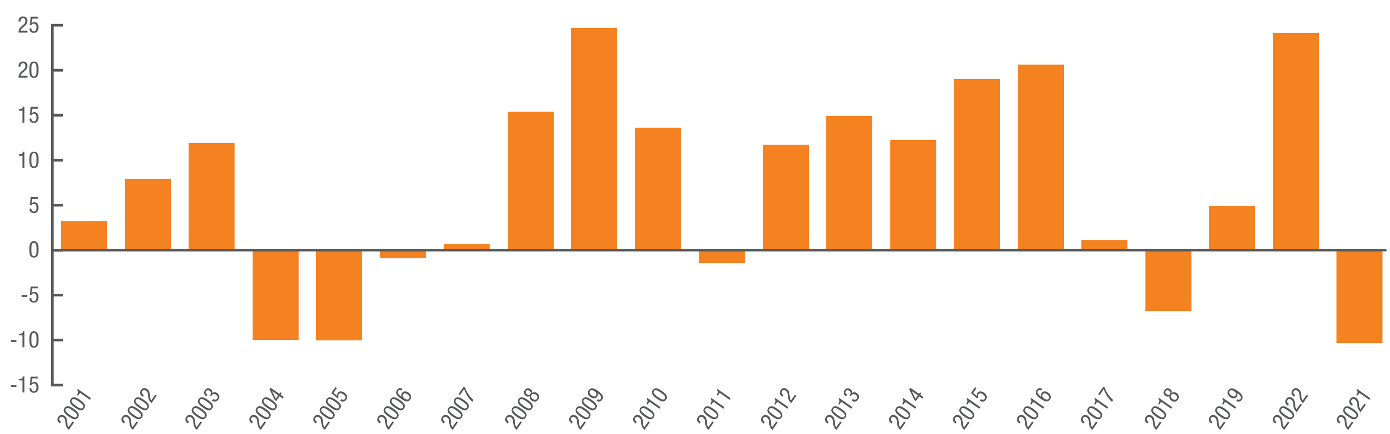
[11] Credit Suisse, May 2022.
[12] Bloomberg, June 2022.
[13] Morgan Stanley, May 2022.
[14] Ibid.
[15] State Council of the People's Republic of China, May 2022.

In the interim, a supply chain recovery should see a pick-up in the second half of the year as Shanghai exited its two-month lockdown on June 1. However, more is needed to restore confidence in light of the enduring zero-Covid policy. Unlike lockdowns experienced elsewhere in the world, a lockdown in China is more deflationary than inflationary, and supply typically rebounds faster than demand.[16] Recognisng the need to make up for the recent pandemic-driven slowdown, the State Council released 33 stimulus measures in May, covering fiscal, financial, investment, and industrial policies.[17] Notably, the Ministry of Finance announced it would complete RMB 3.65 trillion in local government special bond issuance by the end of June, so that the funding can largely be put to work by the end of August.[18] While these measures are a step in the right direction, they are likely to benefit only a select number of industries and underwhelm in reviving consumer spending. Therefore, we expect policymakers to step up further support over the coming months with pro-consumption policies to reinvigorate consumer confidence and lower demand-size constraints.

From an allocation perspective, China is becoming increasingly attractive given its expansionary stance amid the global slowdown. Chinese equities (in particular the onshore A-share market) have shown low correlations with global equity markets, suggesting potentially lower spill-over impacts during a global downturn.[19] Additionally, foreign ownership of A-shares remains low, around 4.5%, making them less sensitive to global shocks and sentiment shifts.[20] These findings suggest that Chinese equities may offer favorable diversification from US markets, especially at a time when US equities are facing a downturn.

The decline in Chinese equities was well ahead of the cycle, driven by the government's regulatory crackdown. For internet companies, investors were concerned that regulations would continue to drag through 2022, generating uncertainty on near-term earnings and the future growth outlook of those companies. However, an overlooked upside is that the regulatory reset provided Chinese internet companies with an opportunity to refocus – to deepen their moats in core businesses, rationalise non-core investments, improve their operating efficiency, and seek higher-quality, sustainable growth. In March, Chinese authorities called for a swift end to the crackdown to limit the further impact on the development of capital markets. With regulatory pressures now easing, we believe that Chinese internet companies are exiting the bottom of the cycle, with strong upside potential if positive catalysts emerge.

China Debt to GDP Delta



Source: CEIC, Morgan Stanley Research, April 2022.

[16] Macquarie, June 2022.
[17] State Council of the People's Republic of China, May 2022.
[18] Ibid.
[19] Goldman Sachs, February 2022.
[20] Ibid.

Northeast Asia

The Northeast Asian region, including South Korea and Taiwan, has not been immune to the global macro environment. A more hawkish Fed, China's Covid-19 resurgence, and ongoing geopolitical tensions have created an uneasy mix of slower growth, higher inflation, and faster policy rate normalisation for the two economies. While both countries avoided widespread outbreaks during the first two years of the pandemic, the Omicron variant has caused the worst spike in infections for South Korea and Taiwan this year.[21] However, high vaccination rates have allowed both countries to shift to a 'living with Covid' approach, limiting the severity of impact on economic activity.

In South Korea, sentiment is showing signs of positivity on the improving pandemic situation and following President Biden's visit, which signaled that the US is engaging with South Korea as a partner of choice. In a joint statement by President Biden and President Yoon, several areas of cooperation between the US and South Korea were specified, including critical and emerging technologies like semiconductors, electric vehicles and batteries, artificial intelligence, and biotechnology.[22] This presents new opportunities for South Korea's high-tech industries, especially considering the business-friendly environment of the newly-elected government. After years of tight spending and labor policies, President Yoon's pro-business stance is now encouraging Korean companies to expand their investment plans. For Korean internet platform companies, however, it may be some time before there is any meaningful recovery. While valuations are attractive and we remain optimistic about the longer-term expansion of these companies, near-term re-opening policies may have a negative impact on demand for online services.

In Taiwan, rising commodity prices, potential disruptions from China's zero-Covid policy, and a slowdown in global demand present headwinds to economic growth. However, when considering the longer-term global transition towards digitalisation and automation, the structural demand for technology remains well in place. As such, the slowdown in external demand is likely to moderate growth towards the trend rate, but leading Taiwan-ese IT names are still expected to grow at a healthy rate.

India

Despite concerns of Fed tightening, the performance of Indian equities has held up relatively well. The International Monetary Fund (IMF) recently updated its global growth outlook, forecasting India's GDP to grow 8.2% in 2022 (vs. 3.6% globally), making India one of the fastest-growing major economies.[23] Much of this growth is expected to be driven by India's growing export market share, supported by a confluence of supply-side driven policy reforms, including the production-linked incentive (PLI) scheme to encourage domestic manufacturing. Since its introduction and expansion to a broader set of sectors, the PLI scheme has attracted substantial foreign direct investment flows and contributed to strong job creation in India.

The Indian Rupee has also exhibited greater resilience compared to other Asian currencies. As of May 31, 2022, the Rupee depreciated 4% YTD relative to the USD.[24] The depreciation is attributed mainly to the sell-off in global equity markets, triggered by the Fed rate hikes, ongoing geopolitical tensions between Russia and Ukraine, and the rebound in oil prices. In comparison, the Japanese Yen and Chinese Yuan have fallen around 12% and 5%, respectively, relative to the USD over the same period.[25] The resilience of the Rupee is supported by healthy foreign exchange reserves of over $600 billion (as of the end of May 2022), up 22% over the last 24 months and more than double 2013 taper tantrum levels.[26] India's current account deficit as a percentage of GDP, while on the rise, is also much lower now than it was back in 2013.[27] All this points to a resilient domestic economy that is likely to fare well under a global stagflationary period. As such, we believe that further depreciation of the Rupee, up to INR 80-82 per USD, can be well-managed by India's economy.

Following the rise in global crop prices, we've seen a pick-up in India's total agricultural exports. This significantly boosts India's rural and semi-urban economy, which has felt the brunt of rising inflation from higher input costs to personal consumption. However, the near-term risk to India's growth story is a further spike in oil prices to $150 or $175 per barrel due to dwindling Russian supply. Every $10 increase per barrel of oil is estimated to increase India's current account deficit by about 0.4% of GDP, and prices are already up roughly $50 per barrel year-to-date.[28] Over the medium term, however, higher oil prices should lead to a cool-off in demand and help alleviate inflationary pressures. We expect to also see an accelerated scale-up of alternative energy sources such as renewables.

[21] Our World in Data, June 2022.
[22] The White House, May 2022.
[23] International Monetary Fund, April 2022.
[24] FactSet.
[25] Ibid.
[26] Reserve Bank of India, June 2022. A taper tantrum is a reaction by investors to the unexpected news that the Fed is slowing bond purchases.
[27] Ibid.
[28] JP Morgan, data as of 13 June 2022.

The Association of Southeast Asian Nations (ASEAN)

ASEAN countries like Indonesia and Thailand demonstrated strong performance in the first half of the year, with the region favored as a global stagflation hedge. Equity outperformance was helped by strong trade flows due to geopolitical tensions, global supply issues, and tight inventory positions – factors that supported commodity prices, despite already being pushed to record highs. This dynamic placed ASEAN commodity exporters back in the limelight due to upward earnings estimate revisions, strong cash flows, and light investor positioning. It also had a positive impact on the currencies of ASEAN markets, which have remained relatively stable over the past six months.

However, outperformance hasn't been consistent across the board. Over the last six months, the US 10-year Treasury yield has more than doubled, hovering around 3.4% as of June 14, 2022.[29] The subsequent equity sell-off during this period saw Asian growth stocks continue to struggle. In particular, ASEAN's new economy tech names with fast revenue growth, but low or negative profit margins, have de-rated the most and experienced sharp corrections. For long-term investors, this provides significant investment opportunities. The ASEAN internet market is still very nascent, with internet penetration growing rapidly as a result of the ongoing adoption of mobile phones and rising consumer power. While focus over the last seven to eight years has been on major US tech companies like FAANG (Facebook, Amazon, Apple, Netflix, Google), the recent US tech sell-off now shines a light on the quality of ASEAN's new economy tech names. Though investor interest may remain low in the coming months amid a rising interest rate environment, we believe that the current valuations of ASEAN internet companies provide ample upside opportunity over the medium to long term.

Within the region, we continue to favor Vietnam as an off-benchmark play. Vietnam exhibits favorable demographics with a young and growing skilled talent pool driving the country's rise as a global manufacturing hub. Despite the pandemic, Vietnam's manufacturing sector has shown remarkable resilience, achieving growth of 5.8% in 2020 and 6.4% in 2021.[30] We expect robust job creation to drive income growth over the coming years, which should benefit leading Vietnamese consumer and financial names. In addition, the government is taking steps to stabilise its capital market and pave the way for a stock market reclassification to "Emerging Markets" by MSCI[31] — this will be a key valuation catalyst for Vietnamese equities in the near to medium term.

Latin America and Emerging Europe, the Middle East & Africa (EEMEA)

General Overview

Latin America and EEMEA, broadly speaking, are well-positioned for the second half of 2022. The Middle East and Latin America should benefit from higher energy prices. Latin America and South Africa would be key beneficiaries of a recovery in Chinese economic activity, and countries like Greece should see dynamic growth coming from a recovery in tourism this summer. Countries in the CE3 (Poland, Czech Republic, and Hungary) should continue to face inflation and growth headwinds. In the following sections, we highlight encouraging signals from key countries within these regions. We believe our regionally focused and actively managed portfolios can continue to generate long-term alpha via rigorous due diligence and stock selection, and by aiming to avoid the various macro headwinds we foresee in certain countries. In our view, Brazil, Mexico, Saudi Arabia and Greece present attractive investment opportunities in the second half of 2022.

Overall, we believe that the combination of a low base for earnings, attractive valuations, and high growth rates create strong prospects for select companies in both Latin America and EEMEA.

Latin America

As a region, Latin America presents an interesting market landscape. The political pendulum appears to be swinging left, as we see leaders like Fernandez in Argentina, Castillo in Peru, Lopez Obrador in Mexico, Boric in Chile, Petro in Colombia, and possibly Lula in Brazil. In normal circumstances, we would see these governments as potential headwinds for financial markets, but today's landscape presents a different situation. First, Latin America should benefit from higher energy prices and oil exports. Second, if we see a reopening recovery in China, Latin America should be key beneficiaries from a price rebound in materials. Last, central banks in the region have been especially prudent in raising interest rates to fight inflation well ahead of the Fed. This has created a strong interest rate differential, which has and should continue to protect currencies through global market volatility. From a valuation perspective, we see Latin America as especially attractive with P/E multiples trading at

[29] Bloomberg, June 2022.

[30] VCSC Research, March 2022.

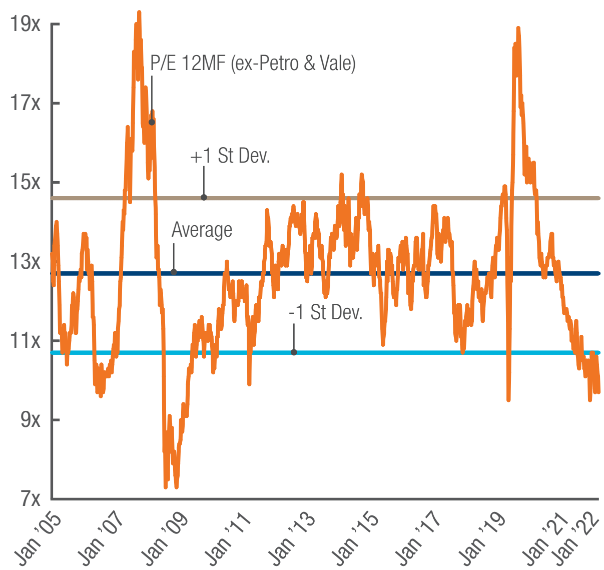
[31] MSCI is a global provider of equity, fixed income, real estate indexes, multi-asset portfolio analysis tools, ESG and climate products.

6.75X, 8.5% dividend yields, and over 20% ROEs.[32] We believe that Latin America presents a dynamic investment landscape where active management, a focus on quality, and sound risk management are paramount.

Brazil

We maintain a constructive outlook on Brazil with a focus on domestic cyclicals. The Monetary Policy Committee (COPOM) raised the Selic rate (the Brazilian federal funds rate) from 2% to 13.25% over the past year and inflation currently hovers around 11.5%.[33] Operators are sensing a peak and economists are expecting inflation to decline to around 9% by the end of the year, creating a powerful real rate situation in Brazil. This positive carry trade in combination with strong commodity prices has translated into a surprisingly attractive backdrop for Brazilian assets. Management teams from consumer-oriented companies recently provided us with a consistent message that demand trends from February to April were looking stronger than they had seen in years. Consumption has come roaring back on (1) pent up demand, (2) the stronger Brazilian Real, which has put a limit on the effects of inflation for consumer good prices, and (3) the consumer class of the economy has retained relatively stable employment levels while increasing savings rates throughout the pandemic. Together, this has created a strong consumer environment in the reopening scenario playing out. Historically, domestic cyclical names have performed well through rate-cutting cycles. These names have lagged commodity benchmark juggernauts in the YTD rally and could see interesting movements with a potential combination of recent earnings recovery followed by the potential end of the rate hiking cycle towards the end of this year. On the negative side, Brazil is still anything but a clear picture. Despite the opportunity for macro strength driven by a carry trade and eventual rate cuts, the current environment shows a low growth and high inflation environment. Politically, on paper, the market is facing a binary presidential race with the leading party carrying a history of fiscal irresponsibility. In addition, Brazilian equities have historically been a volatile place to invest. The country has seen a minimum drawdown of 17% every year since 2000, even in years when returns were positive.[34] Though Brazil stands out from the rest of the world in the form of valuations, positive real interest rates, an advanced interest rate cycle, and a positive consumer reopening environment, there is still a significant amount of uncertainty in the form of politics, inflation, commodity prices, and inequality. The lack of certainty creates opportunities for stock pickers and we are optimistic about the prospects for our current holdings.

Bovespa P/E 12 Month Forward (Ex-Petro and Vale)



Source: BTG actual estimates.

Mexico

Mexican assets have shown resilience, benefitting from strong US growth, high levels of remittances, orthodox monetary policy, and limited exposure to the Russia-Ukraine conflict. Looking into the second half of 2022, Mexico's economy should continue to move with the US, with trade being responsible for roughly 75% of exports and 62% of imports.[35] Politics remains the major topic of discussion, with President Obrador's proposed energy reform bill at the forefront. The bill in its current form has been rejected and is not expected to be passed as the Morena party remains the minority in Congress, providing political gridlock until the 2023 Presidential election. However, President Obrador's party performed well in recent gubernatorial elections and continues to consolidate power and build momentum into next year. Nearshoring, when businesses shift their supply chains to a closer country, should continue to provide a tailwind for the economy and will likely be accelerated due to further uncertainties caused by the Russia-Ukraine war. Mexico is well-positioned to capitalise on this trend since the country is a more cost-effective producer than the US, China, Vietnam and India.[36] The Bank of Mexico should help stabilise the currency, as it has moved ahead of most central banks in raising interest rates in order to tame inflation.

[32] Factset, as of 6/21/2022.
[33] Banco Central Do Brasil, as of 6/3/2022.
[34] FactSet, Goldman Sachs Global Investments, published 4/5/2022.
[35] Itau Research, Mexico Big Book, as of 4/25/22.
[36] 2019 Boston Consulting Group Global Manufacturing Cost-Competitiveness Index.

President Obrador's plan to control prices for key staples and inputs should also help curb inflation in the short-term. The combination of political gridlock, strong US GDP growth, and orthodox monetary policy present an interesting backdrop for Mexican equities.

Andean Region (Colombia, Peru, Chile, and Argentina)

Despite strong commodity prices, political uncertainty and inflation shocks will likely continue to create both risks and opportunities in each country within the Andean region.

Argentina faces macroeconomic challenges with limited triggers for the market, creating a difficult environment for local corporates to outperform in the region. Even with Presidential elections behind us, Chile's market faces a binary outlook driven by the September 4 Constitutional Referendum. However, downside risks from a new constitution are tempered given the country is already trading nearly two standard deviations below historical levels on a P/E basis. The mining sector continues to perform well, and the central bank has proactively moved to raise rates 425 basis points YTD.

Colombia had rallied with oil prices in the first half of the year before giving up some of its gains ahead of the 2022 Presidential election. While we expect the economy to continue to benefit from recent fiscal reforms along with elevated energy prices that should support growth and the country's fiscal position, the outlook remains uncertain following Gustavo Petro's Presidential election victory in June. We see a growing risk of further profit-taking ahead, coupled with increasing political risk as his government seeks to reform the country's tax system and energy sector to finance additional spending. However, his party lacks a majority in Congress, which should limit his ability to pass constitutional reforms. Mr. Petro's Finance Minister appointment will also signal whether orthodoxy at the typically independent central bank will continue.

The Peruvian economy started the year with a furious rally before correcting on climbing risk aversion, social unrest and protests against President Castillo following several impeachment attempts. Climbing inflation is also pushing the Central Reserve Bank of Peru to continue hiking rates, which is supporting the currency and fighting inflation, but creating headwinds for growth. We remain on the sidelines as current high copper prices are offset by political uncertainty and a growing risk that Congress will become more populist in an increasingly complex social environment.

EEMEA

General Overview

In EEMEA, the second half of 2022 looks divergent. Countries like Saudi Arabia, the United Arab Emirates (UAE), and Qatar should benefit from elevated energy prices, a strong USD, and higher interest rates. South Africa's performance should largely depend on China's ability to reopen and stimulate economic growth. Greece, uniquely, should benefit from a strong recovery in tourism and a market-friendly government. Turkey, presents an interesting situation where bad news could mean good news if it leads to changes that drive orthodox monetary policies. Poland, Hungary, and the Czech Republic should continue to battle inflation pressure and a slowdown in European growth. We also continue to monitor for headwinds around nationalism, immigration policies, and political instability, which might create volatility for the region's structural growth and prevent the disbursement of Next Generation EU (NGEU)[37] funding.

Russia

Russia was removed from all MSCI indices on March 9, 2022. Both MSCI and our internal pricing committee have priced Russian securities at effectively zero at that time. At the same time, MSCI has removed Russia from the Emerging Markets benchmark. Though the Moscow exchange has reopened, regulators continue to prevent foreign investors from purchasing or selling Russian equities at the time of writing.

We see the country's economic growth contracting roughly 12% this year. The central bank's initial rate hike seems to have calmed the currency market, and the Ruble now trades at stronger levels than in November 2021. This comes from a combination of higher rates, an elevated energy environment, and the on-shoring of capital back into Russia.

The situation remains fluid, but we see no clear path to a near-term reconciliation in Ukraine.

South Africa

We remain cautious on South Africa as we have seen little progress on the African National Congress (ANC) party's ability to implement reforms and address systematic issues that limit growth. Higher commodity prices, especially for platinum group and precious metals, should provide support for both the currency and the economy, and will help continue to support

[37] NGEU is an economic recovery plan to support European Union member states hardest hit by the Covid-19 crisis.

the fiscal balance as mining represented 10% of government tax revenue in 2021.[38] The South African economy also stands to benefit from a reopening in China, one of the country's largest trading partners, once the current wave of Covid-19 subsides. On the negative side, state-owned power company Eskom has announced significant power cuts for the second half of 2022, which will likely weigh on growth moving forward. Furthermore, consumer prices rose 5.9% in April, nearing the upper end of the Reserve Bank's 3-6% target range. In response to the rise in prices, the South African Reserve Bank hiked its key interest rate by 125 basis points to 4.75% since November 2021[39] and is expected to continue to raise rates, which could also slow economic growth moving forward.

Turkey

We remain cautious on Turkey due to the central bank's unorthodox monetary policy, a widening current account deficit, and political uncertainty to remain high heading into the 2023 election. Inflation in Turkey remains extremely elevated, with the Consumer Price Index rising nearly 70% year-over-year in April.[40] Despite this sharp rise in prices, the central bank, influenced by President Erdogan's unorthodox view on monetary policy, continues to hold its key interest rate at 14%, decoupling from most major global central banks that have entered a period of tightening. Elevated commodity prices, exacerbated by the Russia-Ukraine conflict, have also weighed on economic growth as Turkey is a net importer of most commodities. However, we are also aware that bad news could counterintuitively lift markets as it could lead to an early election and transition in leadership.

Greece

We remain optimistic about Greece for the second half of 2022 as we enter the core tourist season in earnest and the EU Commission's enhanced surveillance program ends in August. Despite elections set for June 2023, we also see potential for early elections in October as the market-friendly government seeks to capitalise on a strong tourism recovery, the recent intervention in energy markets to lower bills, and the increase in the minimum wage starting May 1.

CE3 (Poland, Czech Republic and Hungary)

In addition to the risks from the Russia/Ukraine conflict, the CE3 region is also facing macro headwinds including higher inflation due to climbing energy prices and supply chain disruptions. The CE3 has continued to proactively frontload policy responses to high inflation rates. Though these bank-heavy markets should benefit from higher associated yields, the elevated rates will likely dampen growth. On the positive side, the prudent central bank responses should lead to lower inflation towards the back half of 2022.

We expect Poland's bank heavy market to face headwinds from a new bill that supports Zloty-denominated mortgage loans, a growing risk of a wage inflation spiral driven by loose macro policy until the 2023 elections, and higher inflation driven by strong growth. While retail sales were above expectations on the back of refugee inflows, we anticipate a slowdown going into the second half of 2022 as inflation and rate hikes start to impact household spending.

Despite strong domestic demand, Hungary's open economy exposes it to weakening external demand as it is a large trade partner with Russia and Ukraine. A moderation of real disposable income will likely also drive slower growth as we move into 2023. Furthermore, as we continue to wait for Hungary to form a new government following April's general elections, we see downside risks to EU fund disbursements driven by rule-of-law concerns from the EU.

The Czech Republic is likely to reach an end to its tightening cycle ahead of other countries in the region given the dovish change at the National Bank and a more advanced economic cycle in the region with inflation pressures already starting to peak.

MENA (Middle East & North Africa)

The Middle East continues to present a solid economic backdrop for the second half of the year as most of the countries in the region are still benefiting from the current high oil price environment (the MENA region is one of the only direct plays on higher oil in EM after Russia was reclassified to standalone market status) and their currencies pegged to the USD. Therefore, we expect these countries to benefit from a stronger USD as oil exporters rebuild fiscal buffers and their bank-heavy markets should continue to see margin improvements with higher interest rates. Importantly, we also continue to see progress made with social reforms, which should help support longer-term growth in the region. Finally, the MENA region has around US$33 billion in expected equity offerings in the pipeline that have already been announced,[41] which should continue to increase the region's weight in MSCI indices over time, while providing greater opportunities for active stock selection.

[38] Morgan Stanley Research 4Q21 Macro Slide Deck, 10/11/21.
[39] Bloomberg, as of 5/19/22.
[40] Bloomberg, as of 5/5/22.
[41] Bloomberg, as of 6/3/22.

The Kingdom of Saudi Arabia is a clear beneficiary from the strong rise in oil prices, but they also benefit from strong local liquidity coupled with a diversification and modernisation program from the government. With fiscal breakeven oil price in the high 70's (declining to $69 next year per estimates by the International Monetary Fund), the country's fiscal balance should move from -2% in 2021 (actual) to +5.5% in 2022 (estimated),[42] and should give them greater flexibility in targeting specific areas of the economy such as tourism for growth. We are also encouraged by EPFR data that shows the average EM fund is significantly underweight the country, despite its growing importance in MSCI benchmarks and a strong pipeline of IPO activity.

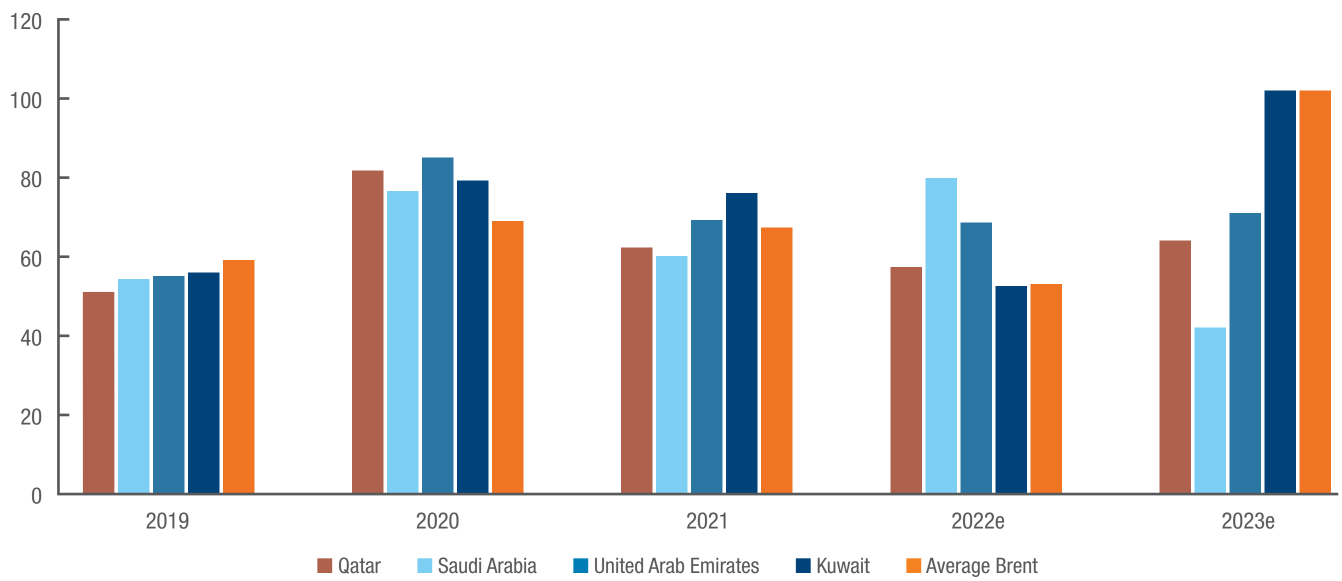
Qatar also has a supportive macro backdrop, with additional tailwinds in the second half of 2022 from this year's World Cup. The country is a clear beneficiary of higher gas prices as the world continues to transition to net zero and they continue to increase their LNG (liquefied natural gas) capacity by 40% by 2026.[43]

We expect the UAE to continue benefitting from the aforementioned economic backdrop and a sustained recovery of tourism across the Middle East and Asia. In addition, we see a resumption of a third growth driver, namely the push towards another global financial hub in the region, given improving immigration policies (e.g. golden visas) that have simultaneously supported their large real estate sector. The UAE also boasts significant traffic from all continents and will likely be a key beneficiary from reopening.

Kuwaiti equities performed well last year after being upgraded to Emerging Market status, driven by high domestic savings and solid local liquidity, but opportunities are more limited now due to expensive valuations and limited structural reform opportunities within the country.

In Northern Africa, Egypt stands out as an attractive investment with tailwinds from a potential recovery in tourism, but inflationary and foreign exchange risks remain a headwind in the short term.

MENA Fiscal Breakevens



Source: National Authorities, IMF estimates, IMF Regional Economic Outlook April 2022. E= Estimated. Estimates are projections and not guarantees.

[42] National Authorities, IMF estimates, IMF Regional Economic Outlook, April 2022.
[43] Quatar Petroleum, February 2021.

DEFINITIONS

Alpha measures the difference between a fund’s actual returns and its expected performance, given its level of risk as measured by beta.
MSCI ACWI + FM Index captures large and mid cap representation across developed markets, emerging market countries and frontier markets.
MSCI China Index captures large and mid cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs) of Chinese stocks. China A shares will be partially included in this index.
MSCI Emerging Markets (EM) Index captures large and mid cap representation across 24 Emerging Market countries.
Association of Southeast Asia Nations (ASEAN) is the organisation of countries in Southeast Asia set up to promote cultural, economic and political development in the region. Basis Point (bp) is a unit that is equal to 1/100th of 1% and is used to denote the change in the value or rate of a financial instrument.
China A-shares are the stock shares of mainland China-based companies that trade on the two Chinese stock exchanges, the Shanghai Stock Exchange and the Shenzhen Stock Exchange.
Consumer Price Index (CPI) measures changes in the price level of a market basket of consumer goods and services purchased by households.
Current account balance is the sum of net exports of goods and services, net primary income, and net secondary income.
Current Account Deficit (CAD) is when a country imports more goods, services, and capital than it exports.
DXY is the US dollar index is a measurement of the dollar’s value relative to six foreign currencies as measured by their exchange rates.
Dividend yield is the ratio of a company’s annual dividend compared to its share price.
Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country’s borders in a specific time period.
Fiscal Deficit is a shortfall in a government’s income compared with its spending.
Initial Public Offering (IPO) is a company’s first sale of stock to the public.
OPEC+ is an alliance between the Organisation of the Petroleum Exporting Countries (OPEC) and non-OPEC producers to rebalance the oil market.
Price/earnings (P/E) ratio is the ratio for valuing a company that measures its current share price relative to its per-share earnings.
Return on Equity (ROE) is a measure of profitability that calculates how many dollars of profit a company generates with each dollar of shareholders’ equity.
Reserve Requirement Ratio (RRR) is the amount of funds that a depository institution must hold in reserve against specified deposit liabilities.
Standard Deviation is a statistical measure of volatility and is often used as an indicator of the ‘risk’ associated with a return series. Standard deviation of return measures the average deviations of a return series from its mean. A large standard deviation implies that there have been large swings in the return series of the manager.

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