MIRAE ASSET
Global Investments

2019 Emerging Markets Outlook

Opportunities Beyond a Tumultuous Year

2019 Emerging Markets Outlook
Emerging Markets At-A-Glance

Capex Cycle
- Attractive investment environment for EM

EM Consumption
- Structural opportunity based on demographics and urbanization

Trade Resolution
- Ready for reversion

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- Consumer Confidence
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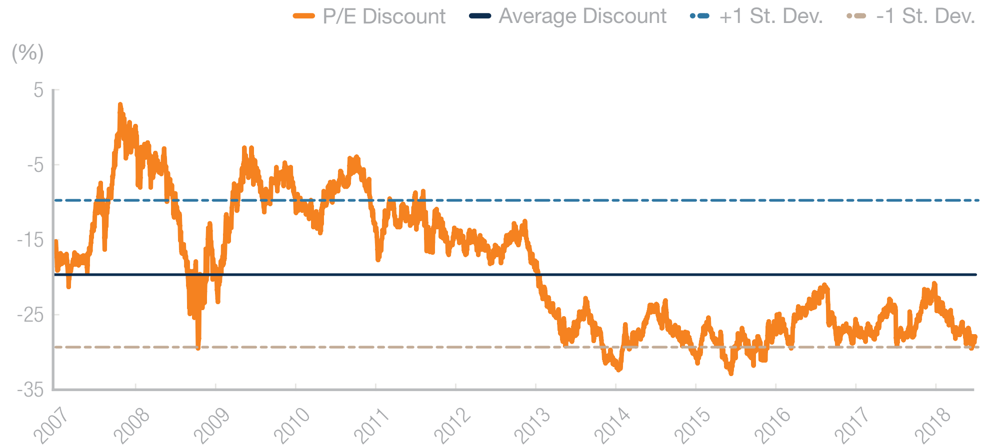
- Decreased Vulnerability

Executive Summary

After a strong 2017, emerging market (EM) equities corrected in 2018 and decoupled from US equities due to trade disputes, rising interest rates, weaker FX, and rising political risks. That said, with idiosyncratic factors behind us, a potential US and China trade resolution on the table, and a consensus view for an end to the US Federal Reserves' rate hiking cycle, we believe EM equities are attractive on a risk-reward basis for long-term investors. This outlook is also based on positioning, valuations, and growth. Despite strong performance in 2016 and 2017, EM equities have remained an unpopular and underinvested asset class. Institutional investors are still over 600 basis points underweight EM equities. This active underweight is over one and a half standard deviations below its historical average, which we believe could revert to the mean in the near future. In addition, EM equities are presenting higher earnings growth rates with similar return profiles and the discount between EM and developed market (DM) multiples is now more than one standard deviation below its historical average. We believe that prices have dislocated from fundamentals and that EM equities are positioned for a significant rally in the coming year.

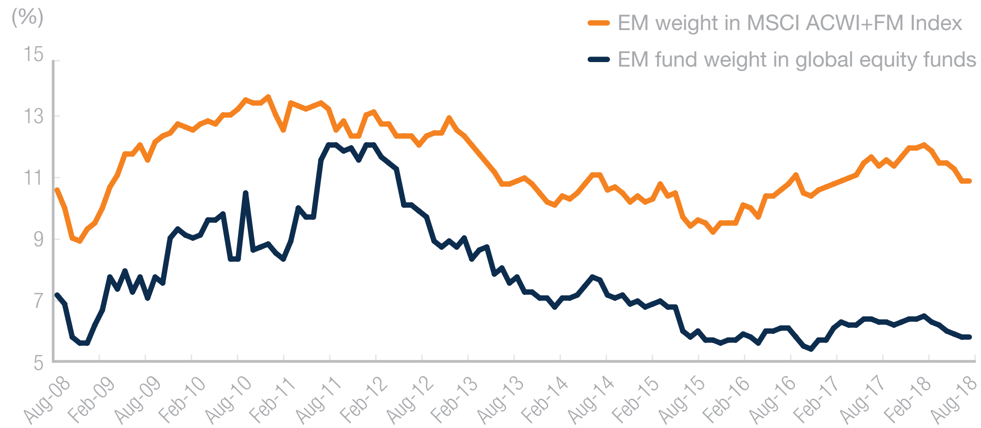
EM vs DM P/E Discount

Source: Bloomberg (2018)



Global Funds Remain Underweight EM

Source: EPFR Global, Thomson Reuters Datastream, HSBC (2018)



On a regional basis, we are looking for a Chinese-led rebound in Asia which could provide a powerful backdrop for the rest of the asset class. In Latin America, we are optimistic that Brazil's reform-oriented president-elect, low interest rates, and a wave of pent-up demand will drive growth. A combination of attractive valuations and low interest rates in Russia could help fuel growth in Emerging Europe. In the Middle East, we are focusing on Saudi Arabia's ability to navigate geopolitical tension, as it enters the MSCI Emerging Markets benchmark as the ninth largest country weighting. In Africa, we see potential for a politically-led turnaround in South Africa and a meaningful monetary easing cycle in Egypt. Asian ex-Japan has shown signs of growth moderation, but the equity market correction this year suggests investors have already priced in the negative news and further downside from current valuations levels appears limited.

Key Events & Trends

▶ Capex Cycle

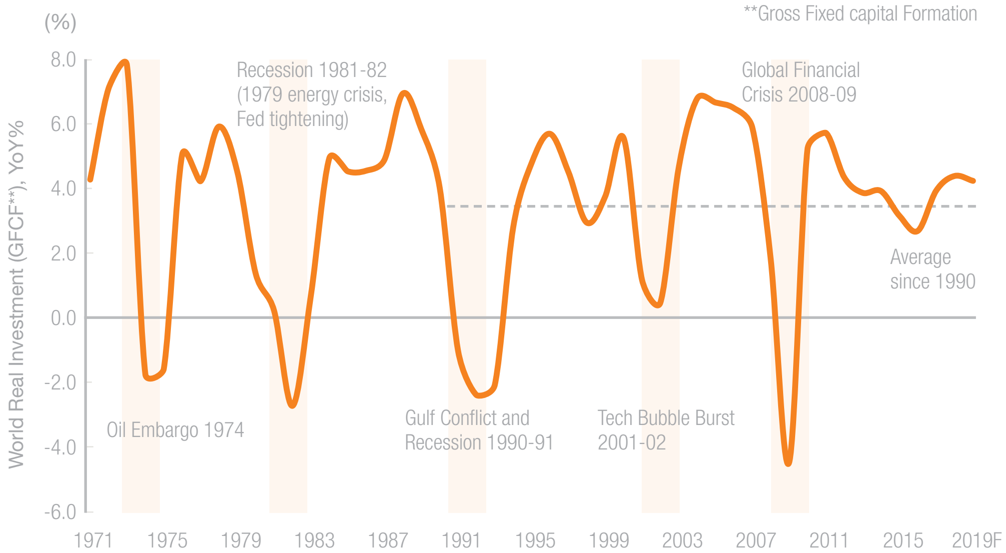
The combination of steady DM growth, improving global trade and accommodative global interest rate policies create an attractive investment environment for EMs. After several years of declining global corporate capex growth which translated into negative demand for EM exporters, capex growth has pivoted back to a positive cycle. EM companies have been focused on balance sheet repair and we now expect to see rising utilization rates. The growth in capex is re-enforced by a supportive credit environment. This recovery in spending should support top-line growth and margin expansion, which should help drive sustainable growth in 2019 and beyond.

▶ EM Consumption

Although the world is focused on geopolitical tension, we believe it is important to remember the significant structural opportunity in the EMs. The rising number of EM consumers are set to transform the global economic landscape for decades to come and this presents a unique investment opportunity based on demographics, urbanization, spending patterns, and technological leaps. Currently, forty-four percent of EM citizens are under the age of 25 and the urban population is growing around 11% per year. Most importantly, EM economies represent 80% of GDP growth but only roughly 15% of global market capitalization. We believe that adjustments in spending patterns will lead to significant growth and eventual asset appreciation cross EM equities.

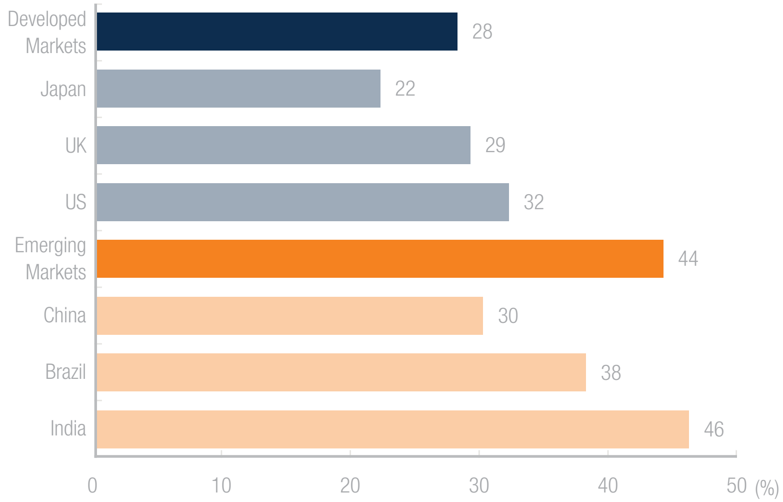
Global Investment Growth

Source: World Bank, Morgan stanley Research (2018)



Percent of Population Under the Age of 25

Source : United Nations, Department of Economic and Social Affairs, Population Division (2017). World Population Prospects: The 2017 Revision.



Total Population
1,260 million
127 million
66 million
324 million
6,290 million
1,410 million
209 million
1,339 million

Trade Resolution

Two years into the Trump Presidency, we are beginning to see a pattern around the administration's trade negotiations, which we believe could bode well for EMs in 2019. In dealing with Europe, the US began with tariffs on steel and aluminum along with threatening up to 25% tariffs on autos – a significant threat to the EU economy – before they resumed talks that were similar to the Transatlantic Trade and Investment Partnership (TTIP). President Trump also very publicly threatened to walk away from the North American Free Trade Agreement (NAFTA) before finding a resolution with both Mexico and Canada. In both situations, the market braced for the worst before reverting on the back of quicker-than-expected compromises. We believe that we are seeing a similar pattern with China. The US has implemented tariffs on approximately US$250 billion worth Chinese goods this year. The Trump administration indicated that it was going to add further tariffs at the start of 2019 if a deal is not reached before then. President Xi and President Trump recently met at the G20 summit and agreed to a 90 day truce agreement, where the US would delay raising tariffs from 10% to 25% on $200bn worth of Chinese imports, with China set to purchase a "very substantial" amount of US products. Nonetheless, we do not expect US-China trade tensions to disappear; rather we believe they will de-escalate going into 2019.

The Chinese government appears open to both improved market access for foreign companies and to higher standards for intellectual property rights. President Xi has also reiterated the government's commitment to supporting private sector companies in China. Conclusively, a de-escalation in the trade dispute between the US and China should act as a meaningful catalyst for an EM led rally in global equities.

Regional Overview

Asia Pacific

Despite external headwinds which have significantly impacted investor sentiment, overall macro fundamentals appear to be sound. Asia Pacific may continue to see short-term volatility as market participants await to gain more clarity on macro issues.

Latin America

Many Latin American governments including Brazil, Chile, Colombia and Peru appear to be shifting back to prudent and fiscally responsible policies after a long period characterized by populist-leaning wealth distribution policies. Consequently, we are optimistic that in 2019 we will see reforms leading to stronger consumer confidence, lower inflation, and increased prospects for growth in the region.

Eastern Europe, Middle East and Africa (EEMEA)

Eastern Europe continues to boast some of the best GDP growth rates in the region, but upcoming EU parliamentary elections could change the political landscape in 2019. Middle Eastern countries are exhibiting increasingly prudent economic policies, supported by relatively stable energy prices, while African countries could benefit from new leadership and structural reforms that may help bring further investment into the region.

Headwinds & Tailwinds

Headwinds

- Strong US dollar and rising interest rate environment
- Potential US-China trade escalation
- EU fragility (e.g.: Brexit, Italian fiscal position and Polish politics)
- Geopolitical-based tariffs and sanctions

Tailwinds

- Global capex cycle
- Potential US-China trade resolution
- End of US rate hiking cycle
- China' stimulus policy taking effect on the real economy
- Prime Minister Modi's possible re-election in India

Asia

General Overview

Market conditions remain volatile due to macro concerns affecting sentiment. US-China trade tensions, broad US dollar (USD) strength and Chinese renminbi (RMB) depreciation have triggered a 'risk-off' mood. However, our view remains that although gross domestic product (GDP) growth across the Asian region is slowing, price corrections, particularly in China, have been excessive and based on a hard-landing scenario.

Asian currency depreciation, particularly RMB depreciation, remains an area to watch. China's narrower interest rate differential with the US may continue to put pressure on the RMB in the near term. However, following the tax stimulus in 2018, it is likely that the US economy is close to its cyclical peak. We believe that in the coming quarters, the US Fed may change its hawkish tone and the consensus long USD positioning is likely to unwind. Moreover, the US trade and fiscal deficit is still large, which should over time, have a correcting effect on the currency exchange rate.

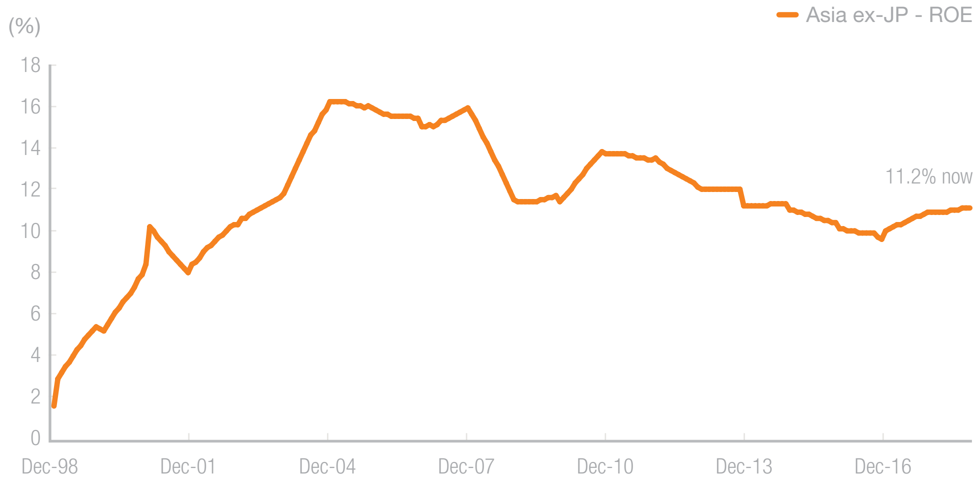
Current price-to-book valuations for Asia ex-Japan equities are close to their 2016 market lows. We expect short-term volatility to continue as market participants wait to gain some clarity on key global macro concerns. However, Asian markets should offer better risk reward opportunity in 2019 as the positive impact of measured consumption stimulus works through the Chinese economy and market participants gain more clarity on Prime Minister Modi's re-election.

Asia ex. Japan P/B

Source: Credit Suisse (2018)

Asia ex. Japan' ROE

Source: Credit Suisse (2018)



China

The Chinese market has been volatile in the second half of 2018 due to macro concerns. US-China trade tensions, broad USD strength and RMB depreciation have triggered a 'risk-off' mood and there has been greater selling pressure in both onshore and Hong Kong markets.

Macro data points, including industrial production, fixed asset investment and retail data have shown signs of moderation since May. The softer data is consistent with the government's earlier deleveraging and tightening efforts. In recent months, China has shifted toward policy stimulus as indicated by the central bank's reserve requirement ratio cuts and liquidity injection into the banking system, more infrastructure spending, tax cuts and pro-consumption stimulus. There are early signs that policy easing is taking effect, such as the broad credit growth rebound helped by faster local government bond and corporate bond issuance. It is important to bear in mind that it takes time for policy easing measures to be passed on to the real economy.

Monetary conditions have begun to turn

Source: Bloomberg (2018)

Consumer confidence has declined from multi-year highs; however, overall retail sales have remained fairly steady. Our on-the-ground observations are that consumer sentiment has not been significantly impacted. Chinese lawmakers passed an amendment to the personal income tax law, which came into effect on October 1st. It included raising the minimum threshold for personal income tax exemption as well as adding special expense deductions for education and caring for the elderly. Along with the policy easing measures, we expect this to boost consumption in the coming months.

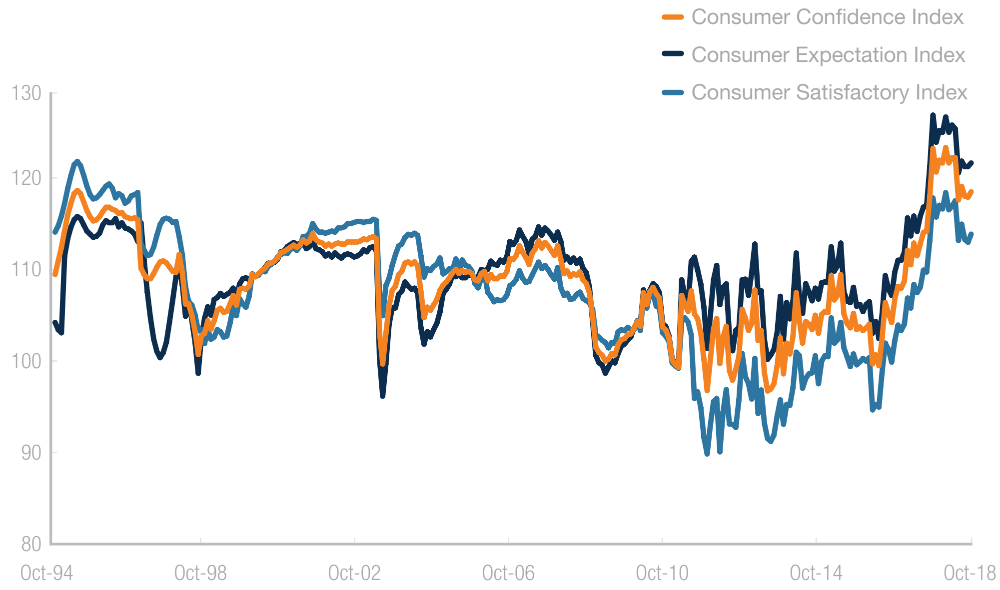
Northeast Asia

Taiwan performed well this year, in part driven by investors seeking defensive positions amid global market uncertainty and China-US trade tensions. Exports have remained resilient, but have yet to impact domestic demand as consumer spending and consumer confidence remain fairly subdued.

Similarly in South Korea, export momentum has sustained a healthy level of growth with semiconductors being a key driver. However, overall domestic demand conditions remain relatively weak. In 2018, the government implemented measures to improve labor market conditions including raising minimum wages, which has dampened business sentiment. In our view, the government is unlikely to push for further pro-labor policies in the near term.

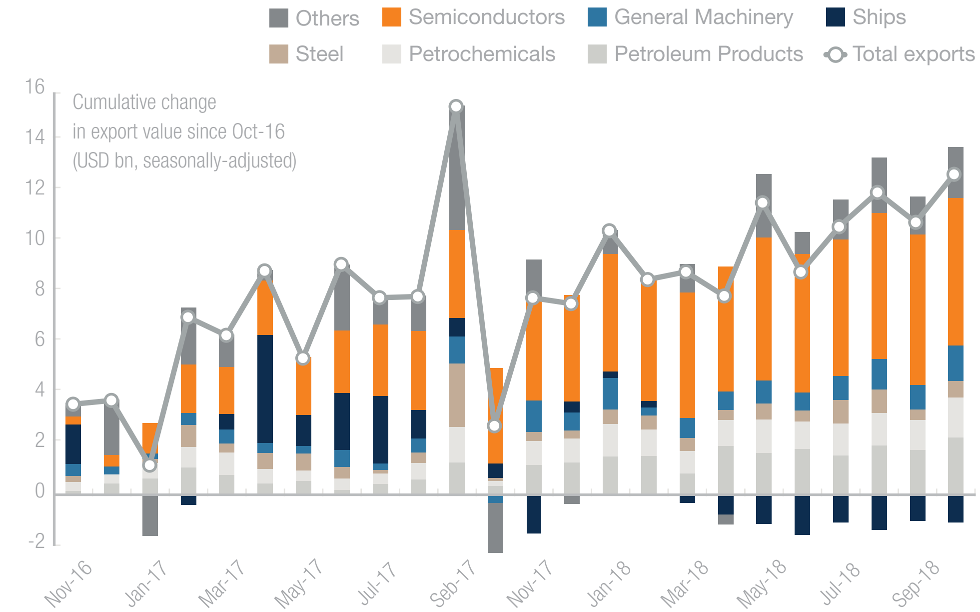
China Consumer Confidence

Source: CEIC, Morgan Stanley (2018)



South Korea export value breakdown by product

Source: CEIC, Haver, MOTIE, Morgan Stanley (2018)



India

Overall macro data in India remains fairly heathy following last year's Goods and Services Tax implementation. Despite some near term external headwinds, we believe that India's growth recovery remains on track with support from consumption, exports and nascent signs of revival in overall capex.

Rupee (INR) depreciation has been an area of concern for investors but we believe this is an overdue correction as the INR had appreciated by approximately 20% in real effective exchange rate terms since mid-2013. We expect the INR to settle between 72 and 75 relative to the USD, which would be close to its long-term average. Liquidity concerns that triggered the default and credit rating downgrade of a major infrastructure firm weighed on market sentiment in recent months. We view this as more of an isolated event rather than a systemic risk issue. Importantly, the government and the Reserve Bank of India have since stepped in to alleviate the liquidity concerns.

The Indian market may continue to experience short-term volatility as market participants await to gain clarity on key global macro concerns and Prime Minister Modi's re-election prospects. However, our outlook for India is very positive amid global trade tensions given that domestic demand is the country's key driver of growth.

Real Effective Exchange Rate of Indian Currency

Source: Reserve Bank of India (2018)

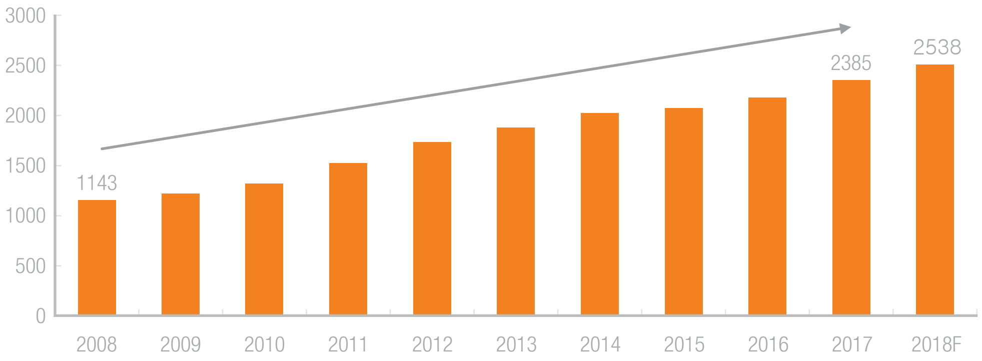
The Association of Southeast Asian Nations (ASEAN)

South East Asian markets have come under stress in a strong USD and rising US interest rate environment. Indonesia, Malaysia and Philippines are the most vulnerable in the region. However, and more importantly, the region is in better shape than it was during the 2013 Taper Tantrum. Credit growth has slowed and in certain cases deleveraging has occurred. There are broad based improvements in current account balances and foreign exchange reserves are generally at levels considered sufficient to fend-off liquidity shortages.

We continue to see favorable opportunities in Vietnam (though the country is still classified as a frontier market by MSCI). Vietnam's economic growth momentum remains robust with GDP growth reaching 7.1% year-over-year in the first half of 2018. The manufacturing sector remains the primary contributor to growth and the services industry continues to perform well due to rising wages and strong tourism numbers. Additionally, Vietnam is likely one of the key beneficiaries of multinational corporations exploring manufacturing locations outside of China in order to reduce the US tariff impact.

Vietnam - GDP per capita has doubled in the last 10 years

Source: World Bank, VCSC Research (2018)



LatAM

General Overview

After a year defined by election cycles and uncertainty, investors should begin to appreciate attractive fundamentals in Latin America (LatAm). LatAm economies should benefit from a shift back to prudent and fiscally responsible policies and we believe this allows for the necessary reforms that will lead to growing consumer confidence, stronger currencies, lower inflation, and better prospects for growth.

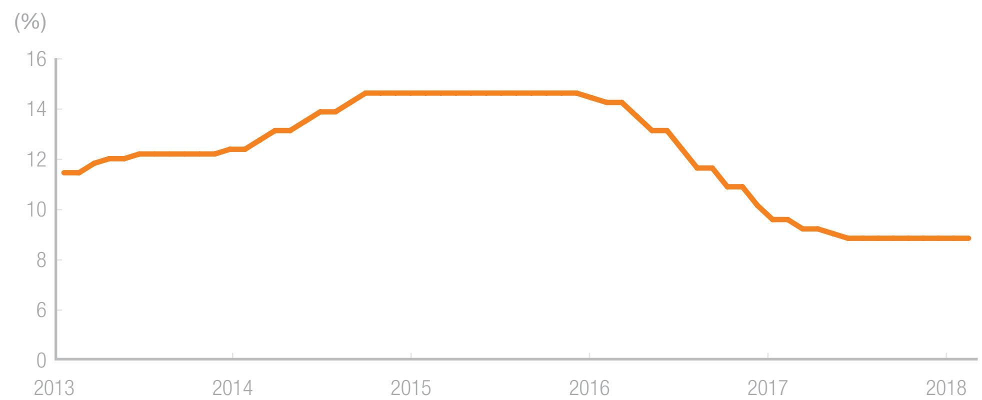
Although LatAm as a whole is benefitting from recent commodity strength, the outlook for each country is unique. Brazil is entering 2019 with strong positive momentum after the recent election of Jair Bolsonaro on prospects of pension and other fiscal reforms. Chile's President Piñera is seeking to restart economic growth by tackling tax, pension, and labor reform. Colombia, which is a key beneficiary of higher oil prices, is looking to address fiscal shortfalls in their budget, which may allow for progress on their much-anticipated 4G infrastructure project. Argentina continues to face inflationary headwinds, but now has the backing of the International Monetary Fund and strong catalysts on the horizon in the form of MSCI inclusion and elections in 2019. Mexico, however, has seen investor confidence dissipate despite positive NAFTA renegotiations due to President-elect López Obrador cancelling the new Texcoco airport in Mexico City.

Brazil

We remain optimistic on Brazil due to a combination of factors. President-elect Bolsonaro has vocally supported pension reform, opening the economy (minimizing a legacy of Import Substitution Industrialization), central bank independence, and privatizations. We view these market friendly pillars as positives for foreign direct investments (FDI), the currency, and continued controlled inflation. Brazil is entering the new year with single digit inflation rates and a central bank that has cut interest rates by more than 750 basis points since the end of 2016. The fact that unemployment still hovers around 12% and 2018 growth remained tepid tells us that there is a significant amount of pent-up demand that should translate into spending and growth for the foreseeable future.

Brazil's Declining Interest Rates

Source: Bloomberg (2018)



Brazil's Unemployment Remains High

Source: Bloomberg (2018)

Mexico

Mexico presents a complicated situation for 2019. Though the market should feed off a healthy US economy and an updated version NAFTA, president-elect Andrés Manuel López Obrador (AMLO) has begun to show his colors as a market unfriendly leader. In late October, AMLO moved forward with the cancellation of the new Texcoco airport in Mexico City, raising concerns among foreign investors. AMLO also mentioned that he would like to implement referendums for more political decisions and that he would rule in the interest of the people and not the free market. With this rhetoric, AMLO is hinting at altering the constitution. We believe that these actions and words have opened the door to government interference in the private sector along with a potential sovereign downgrade, which leaves investors with an opaque environment for Mexico's equity market.

Andean Trio (Colombia, Peru, Chile)

After elections in all three countries in 2018, we see a movement towards more orthodox economic policies with a strong focus on economic growth, with unique reform agendas that aim to resolve economic imbalances in 2019. In Chile, tax, pension and labor reform will likely be the key economic drivers. President Piñera's Tributary Modernization Project aims to boost investment and gradually reduce the corporate tax rate towards the OECD average of 21.94%, while proposed pension reform seeks to increase mandatory contribution levels from 10% to 14% over an eight-year period. Colombia is taking steps to increase fiscal revenues to meet their fiscal rule targets. This includes widening the base of products with a value-added tax (VAT) while reducing the VAT rate from 19% to 17% by 2021, reducing corporate tax rates and tax evasion, and simplifying the existing tax regime. President Duque also plans to reform the pension system and increase coverage for the local population. That said, Colombia has one-term presidential limits and Duque may face an uphill battle pushing reforms into the end of his term. Peru is boasting the continent's best GDP growth outlook, which gives the government the luxury to clamp down on corruption. President Vizcarra has four constitutional reforms on the December 9, 2018 referendum as he seeks to rebuild trust in domestic institutions. Potential reforms include changes to the Council of Magistrates, reinstating a bi-cameral congress, term limits for congressmen, and the prohibition of anonymous financing of political parties.

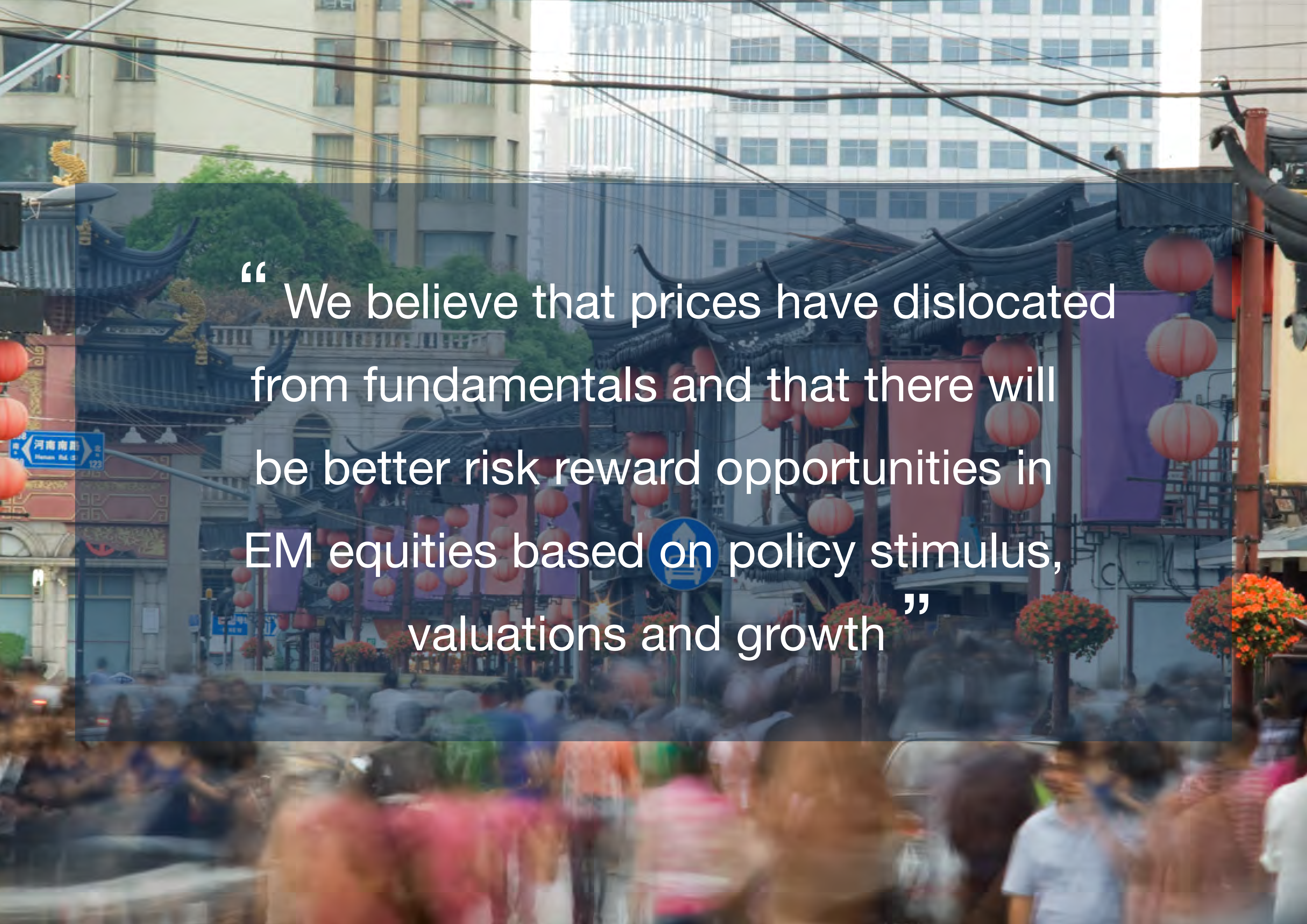
EEMEA

▶ General Overview

EEMEA contains a wide-range of opportunities based on valuation, growth, economics, and politics. We see opportunities for outperformance in both Egypt and Saudi Arabia driven by prudent economic policies, a low base for geopolitical tension, and a stable energy backdrop. We continue to believe that Russia is both undervalued and well positioned to benefit from a combination of low inflation, a stable currency, and increasing foreign investment from China and the Middle East. Countries in Eastern Europe, should continue to boast high GDP growth rates, but are vulnerable to a slowdown in Western Europe. South Africa will likely benefit from new leadership and the potential low hanging fruit in the form of structural reforms. Turkey, though coming from a low base, continues to struggle with twin deficits and the burdens of an executive presidency.

Russia

Sanctions have dominated headlines surrounding Russia for most of 2018. Now that the US has a divided congress, we expect the trend to continue in 2019, which may create a deeper disconnect between fundamentals and prices. Despite this, we expect Russia's strong domestic macroeconomic environment to provide a robust backdrop for steady growth over the medium-term. Russia should also continue to benefit from a potential upside in oil as OPEC+ production cuts and a strong US dollar have resulted in high profitability for domestic oil companies. Meanwhile, the conservative Russian budget is still based on a US$40/barrel oil environment. Importantly, we also expect further integration between the EU, Russia, and China as energy security remains a key priority for all three actors.



> "We believe that prices have dislocated from fundamentals and that there will be better risk reward opportunities in EM equities based on policy stimulus, valuations and growth"

South Africa

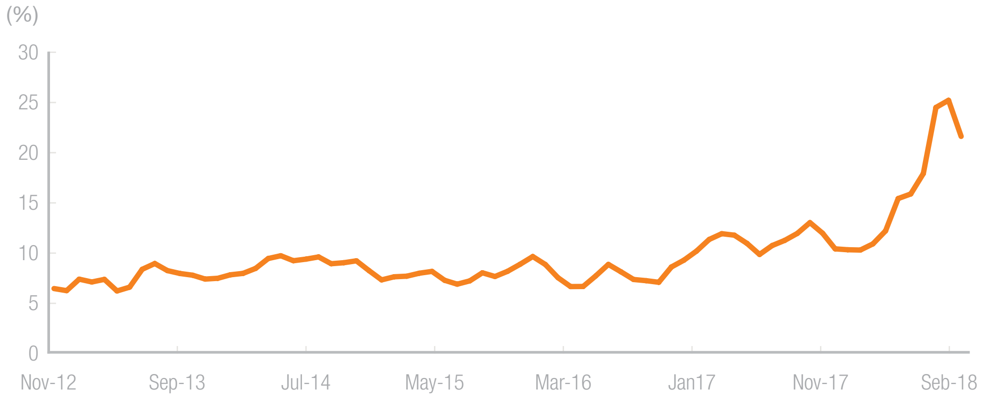
South Africa began 2018 on a positive note after Cyril Ramaphosa won the election for leadership of the African National Congress and became President. Since then, domestic politics have prevented any meaningful domestic policies, such as black economic empowerment and a mining chart, from being enacted. The country slipped into a technical recession in the second half of 2018 as oil prices climbed and the rand weakened, exacerbating the country's current account deficit. Despite this, we remain optimistic on elections in 2019 as another Ramaphosa victory will likely give him the ability to create his own cabinet and greater control over implementing domestic policy directives that can help drive economic growth and stability.

Turkey

Turkish growth and valuations are coming from a low base after a difficult year. The lira has depreciated significantly and equity multiples are among the lowest in EM. That said, Turkey is still very sensitive to the global macroeconomic environment. Given that the country has a government that continues to trade with both Iran and Venezuela, a leader that is consolidating power from different ministries, double digit inflation, and an economy with both fiscal and current account deficits, we believe that Turkey could continue its volatile run in 2019.

Turkey's High Inflation Rate

Source: Bloomberg (2018)



Other EEMEA Countries

The Middle East and Northern Africa are presenting two interesting stories via Egypt and Saudi Arabia. In Egypt, the government has committed to austerity and unpegged its currency, which has already led to improvements to the country's twin deficits along with an uptick in FDI. Inflation rates are stabilizing and the central bank could continue its rate cutting cycle in 2019, which could translate into growth. Saudi Arabia is walking a fine line as it navigates geopolitical tensions over the death of a Saudi reporter in Turkey and the government's reforms to diversify its economy and move the Kingdom into a more modern era. In addition, Saudi Arabia has been accepted into the MSCI EM Index and should be included in the second half of 2019 as the ninth largest country, by market cap, in the index.

The CE4 (Poland, Czech Republic, Romania, and Hungary) should continue to boast high growth rates, as the countries benefit from a normalization of economic policy, reflationary government initiatives and divestment of EU infrastructure funds. Each of these countries present relatively educated population bases with attractive tax rates and low costs of labor, which should continue to attract investment through 2019. That said, these countries are also vulnerable to negative EU headlines around nationalism, trade disputes, and challenging rhetoric on immigration policies.

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