CITY OF LONDON
Investment Management Company Limited

# Emerging Markets Quarterly Outlook

**January 2024***

## Overview

### Staying the Course

*Emerging market equities ex-China were supported by lower US rates and a softer US dollar over the quarter, while the broader index was weighed down by weakness in China. 2024 earnings estimates remain favourable for China and EM, leaving the overall index set up for re-rating from its depressed valuation multiple. Our strategic allocations are unchanged this quarter as we are positioned for a global semiconductor recovery, further US supply-chain readjustment, and a renewable energy transition.*

Since our last EM Quarterly, US rates and the US dollar have moved favourably for EM assets. The US is now pricing in five cuts over 2024, and the US 10-year yield is trading about 100bps lower than its peak of 5% in October. Also, the rate decline has pushed the US dollar 4% lower over the same period (based on the Bloomberg Dollar Index). Historically, these factors correlate with EM equity outperformance as debt, capital flow, and exchange rate pressures ease. Indeed, EM ex-China was strong over Q4, rising 13%. However, the broader index underperformed developed market equities due to further weakness in China.

We remain optimistic about the prospects for EM equities in 2024. Earnings estimates for the MSCI EM Index are 18% higher yoy in 2024. These estimates are well above major DM peers, yet EM continues to trade at a modest 12x 2024 forward P/E multiple compared to 17x for the MSCI ACWI Index. A significant driver of EM earnings this year is a further recovery in the global semiconductor cycle, which is already underway, as evidenced by rising global sales. A continuation of this recovery justifies a re-rating of EM equities to a multiple more in line with its DM peers.

One headwind for EM has been the ongoing weakness in Chinese stocks. Last quarter, we moved our underweight to neutral due to improving activity data from China following various policy measures. Admittedly, this upgrade was premature as the MSCI China Index has continued to underperform. However, we continue to see risks as more balanced given China's low valuation multiple and ongoing policy support. We note that consensus expectations for 2024 earnings are comparable for China and India, yet China trades at a forward multiple of 9x compared to India's 22x. While investors may remain concerned about some of China's long-term structural challenges, global investors may look to reengage in China and EM assets if some underlying drivers improve this year.

Outside China, the recovery in the global semiconductor cycle is supporting the EM Tech sector. We expect Taiwan will benefit from this improvement, while the market is also well positioned to profit from further adoption of Artificial Intelligence (AI) via stronger demand for advanced chips. We remain overweight Vietnam, Indonesia, and Malaysia to capture US supply-chain readjustment trends. Even if US-China tensions moderate this year, nearshoring and friend-shoring trends are unlikely to reverse in the current geopolitical environment. India will also benefit from this thematic driver in the long term, but the market offers limited value at its current elevated multiple. We, therefore, stay underweight. In commodity-linked markets, we remain overweight Saudi Arabia due to the country's ongoing diversification efforts in the non-oil economy. In South Africa, we stay underweight as power supply issues weigh on the economy, while political instability will prevent meaningful change following this year's election.

**Market Strategy**: Our strategic views are unchanged. Relative to the previous quarter, we made one change to country allocations:

- We upgrade **Chile** to *overweight*. The Chilean economic cycle is improving following a slowdown last year, while the central bank is expected to continue cutting interest rates. In addition, the domestic political environment has stabilised. In the long term, the economy should benefit from structural copper demand linked to the renewable energy transition. Overall, Chile offers attractive medium and long-term prospects. We fund the upgrade by reducing our *overweight* to **Indonesia** ahead of the general election this year.

### EM Country Allocation

| | Chg | -2 | -1 | 0 | +1 | +2 |
|---|---|---|---|---|---|---|
| **Asia** | | | | | | |
| China | - | | | ■ | | |
| South Korea | - | | | ■ | | |
| Taiwan | - | | | | ■ | |
| Malaysia | - | | | | ■ | |
| Indonesia | ↓ | | | | ■ | |
| Philippines | - | | ■ | | | |
| Thailand | - | | ■ | | | |
| Vietnam | - | | | | | ■ |
| India | - | | ■ | | | |
| **Latin America** | | | | | | |
| Brazil | - | | | ■ | | |
| Mexico | - | | | ■ | | |
| **Europe, Middle East and Africa** | | | | | | |
| Turkey | - | | ■ | | | |
| Saudi Arabia | - | | | | ■ | |
| South Africa | - | ■ | | | | |

*Note: Up/down arrows indicate a positive/negative change in our asset allocation compared to the previous quarterly outlook. A dash indicates no change. The table shows the major Emerging Markets.*
*Source: CLIM*

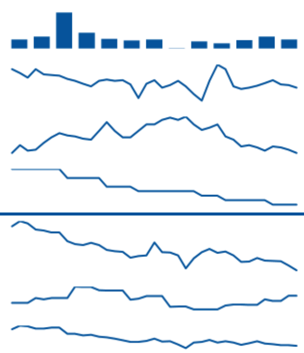
**The publication reflects asset performance up to 29 December 2023, and macro events and data releases up to 8 January 2024, unless indicated otherwise.*

# Asia

## China

*Neutral*

*An uptick in domestic activity could induce a market rally.*



| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 4.9 | Q3 |
| PMI, index | | 49.0 | Dec |
| CPI, % yoy | | -0.5 | Nov |
| Policy rate, %* | | 10.50 | Dec |
| MSCI China** | | -12.1% | Q4 |
| EPS, % yoy | | 1.6 | Dec |
| 12M Forward P/E | | 9.1 | Dec |

**Required Deposit Reserve Ratio for Major Banks.*
***US$ total return relative to MSCI EM.* *Source: Bloomberg*

Chinese equities continued to underperform over the last three months, producing some of the weakest returns of any country in 2023 (-4.2%). At year-end, the MSCI China Index was trading at 9x forward earnings, a 24% discount to the EM aggregate and more than two standard deviations below its five-year average.

In recent months, Chinese policymakers have introduced several targeted measures to improve the economy and domestic stock market. These have not yet induced a significant positive market response but suggest a willingness to intervene and support the equity market. In addition, low Chinese inflation means that policy can remain accommodative. Despite some disappointment in 2023 earnings, the equity market is expected to produce 14% earnings growth this year, which is not reflected in China's low multiple. Furthermore, there is limited international ownership of A-Shares, meaning that an uptick in domestic activity could drive a market rally.

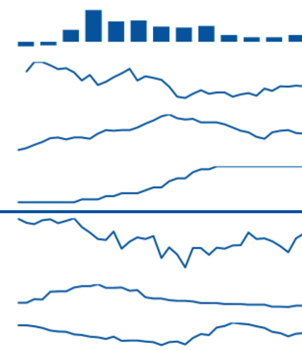
Geopolitics remains a risk, and the Taiwanese election results may prove important for regional stability. However, the recent Xi-Biden meeting in November indicates a desire from both sides to stabilise US-China relations, while positioning and sentiment data show investors have already incorporated US-China geopolitical risks. Our long-term outlook includes ongoing strategic competition between the US and China, but China's fragile economy will likely push authorities towards external engagement rather than escalation this year.

**Market Strategy**: Chinese stocks' depressed multiple on various valuation measures reflects investors' general negative sentiment towards the market. Some of these structural concerns are justified, particularly in the real estate sector. However, investors may reengage in the market this year as policy measures gain traction. We remain *neutral.*

## South Korea

*Neutral*

*A global semiconductor sales recovery supports revenue growth.*



| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 1.4 | Q3 |
| PMI, index | | 49.9 | Dec |
| CPI, % yoy | | 3.2 | Dec |
| Policy rate, % | | 3.50 | Dec |
| MSCI South Korea* | | 7.4% | Q4 |
| EPS, % yoy | | -40.0 | Dec |
| 12M Forward P/E | | 11.2 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

The MSCI Korea Index is forecast to produce the most robust earnings in EM this year, a sharp contrast to negative earnings growth last year. This strength is mainly driven by an improvement in EM tech earnings following the semiconductor downcycle in 2022-23. The recovery is evident in rising global semiconductor sales and a trough in memory chip prices, which will likely support the equity market.

The domestic economy has been relatively weak, with the manufacturing PMI printing at 49.9 in December. However, there has been an upward trend in the last two quarters. Inflation has also been relatively benign, and the central bank has kept rates constant at 3.5% for most of 2023. There are growing expectations of rate cuts in 2024, but these may be delayed if household debt grows faster than expected – which is possible given the recent expiry of the government's facility loan program.

**Market Strategy**: MSCI Korea had total returns of 15.3% over the three months to the end of December, beating the EM aggregate. It trades at a forward PE ratio of 11x, down from its April peak of 14x, and has recently dipped to a discount to MSCI EM. The discounted valuation and exposure to long-term AI growth are appealing. However, we prefer to overweight Taiwan given that market's higher exposure to advanced chips. In addition, South Korea historically has a higher beta to the global equity cycle, leaving the index vulnerable to late-cycle risks. We remain *neutral* on Korea.

## Taiwan

*Overweight*

*Growth in AI and advanced chip demand should support earnings.*

| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 2.3 | Q3 |
| PMI, index | | 47.1 | Dec |
| CPI, % yoy | | 2.9 | Nov |
| Policy rate, % | | 1.88 | Dec |
| MSCI Taiwan* | | 9.5% | Q4 |
| EPS, % yoy | | -33.5 | Dec |
| 12M Forward P/E | | 16.0 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Taiwan is unique given its strength in the advanced semiconductor industry and the broader tech sector. The recent challenges in opening the TSMC fab in Arizona indicate Taiwan's incumbent position is strong. The semiconductor sector has been weak in recent periods, but there are signs that it has begun to rebound, and we remain confident in its long-term prospects, and the growing importance of AI. The large tech weight in the Taiwanese index and the country's advanced chip-leading role mean that the equity market is positioned to benefit from these trends.

MSCI Taiwan is trading at a forward PE of 16.0, a significant premium to MSCI EM. Given the country's importance in the global tech sector, we think this premium is sustainable. Furthermore, 18-20% annual earnings growth is projected over the next two years, which if delivered, would likely place Taiwan as one of the strongest EM and global markets.

The Taiwanese general election results will likely have important geopolitical ramifications. At the time of writing, the incumbent Democratic People's Party (DPP) has a narrow lead in the polls, suggesting that the current political status quo will be maintained, and the Taiwan Strait will likely remain a source of geopolitical tensions this year. However, if the Kuomintang (KMT) party wins, the group tends to favour closer ties to China, which may diffuse geopolitical tensions.

**Market Strategy**: Despite trading at a premium to the EM aggregate, we expect robust advanced semiconductor demand and Taiwan's near-industry monopoly will continue to propel earnings and justify a higher valuation. We remain *overweight* the market.

## India

*Underweight*

*India's valuation measures remain unattractive.*

| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 7.6 | Q3 |
| PMI, index | | 54.9 | Dec |
| CPI, % yoy | | 5.6 | Nov |
| Policy rate, % | | 6.50 | Dec |
| MSCI India* | | 4.0% | Q4 |
| EPS, % yoy | | 2.6 | Dec |
| 12M Forward P/E | | 22.2 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Indian stocks have continued to outperform, returning 11.9% in the final quarter of 2023, ahead of 7.9% for MSCI EM. Indian equities often move in an opposing manner to the Chinese index, and India is, in part, a beneficiary of the current outflow from Chinese stocks. There are several positive factors drawing investors to Indian assets, including the country's growing global presence and robust earnings growth. However, Indian equities trade at a P/E multiple that already reflects this optimism and leaves limited scope for sustained outperformance of the broader EM universe over the medium-term.

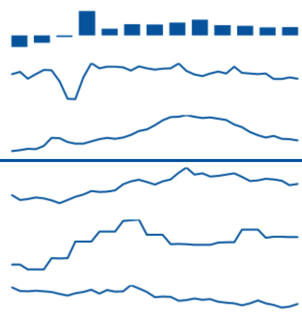
The market trades at a 22x forward PE multiple, significantly above its five-year average and a 99% premium to MSCI EM. Following strong earnings growth in 2023, some premium to EM is reasonable. Still, growth may come under pressure given the country's large fiscal deficit and relatively tight monetary policy. In addition, the elevated multiple leaves stocks vulnerable to de-rating should earnings fail to meet expectations.

India is scheduled for a general election in mid-2024. It is widely expected that Modi will win a third term – his party (BJP) did well in recent state elections – but there is a question as to whether he can maintain a single-party majority. If he can win more than 50% of the vote (or near 50% and combine with a like-minded party), then there is a greater chance that the government will be able to pass more impactful policies (e.g., renewable energy for greater energy independence).

**Market Strategy**: Positive momentum in Indian stocks has been strong, which we think is partly driven by capital outflows from China into the next largest alternative market (India). We maintain our stance that Indian equities are expensive and other EM markets offer better value. We remain *underweight*.

## ASEAN

*We favour ASEAN markets that will benefit from supply chain shifts.*



| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy* | | 4.4 | Q3 |
| PMI, index | | 49.7 | Dec |
| CPI, % yoy | | 2.3 | Nov |
| MSCI ASEAN** | | -4.1% | Q4 |
| EPS, % yoy | | 10.9 | Dec |
| 12M Forward P/E | | 13.1 | Dec |

**PPP GDP weighted.*
***US$ total return relative to MSCI EM.* *Source: Bloomberg*

Economic activity in the region is gradually stabilising, helped in part by China's economy seemingly reaching a trough. The outlook is still soft, however, as prior monetary tightening and a DM slowdown keeps a lid on growth. Cautious of their external balance (Philippines, Indonesia) and the impact of subsidy reform (Malaysia), most ASEAN central banks are not expected to ease policy until at least H2 and only after the Fed has moved. Nonetheless, we see attractive value in markets with relatively stable governance that can benefit from US-China decoupling.

### Malaysia

*(Overweight)*

Malaysia's economy appears to be turning a corner, which should provide some support for its stock market. Moreover, Malaysia's defensively tilted equity market (24.5% of the MSCI Malaysia Index) is well placed ahead of a likely global slowdown. The manufacturing PMI is tentatively bottoming out, while leading indicators and Malaysia's advanced de-stocking cycle suggest a recovery in the electronics and semiconductor sectors. However, DM weakness could temper gains. A continued recovery in tourism should be supportive with arrivals from China expected to pick up further given the recent mutual visa exemption program.

The 2024 budget aims to keep the fiscal path on track to average a 3.5% deficit over 2024-2026. The budget includes phasing out food, diesel and electricity subsidies and increasing the services tax. The government may need to be more aggressive with rationalising petrol subsidies, which are an inflationary risk. Therefore, the Bank Negara Malaysia (BNM) will likely keep rates on hold for the next year, with the potential for precautionary rate hikes.

**Market Strategy**: Valuations for Malaysia's stock market have been broadly stable for the past quarter, with the 12m forward P/E premium over EM in line with its five-year average. The unity government appears serious about fiscal consolidation, while political risks are limited following state elections last year. We keep our *overweight*.

### Indonesia

*(Overweight)*

The focus in the near term is the upcoming election, but with political continuity likely, we maintain our positive long-term economic outlook. The leading presidential candidates have broadly signalled a continuation of incumbent President Jokowi's signature policy of commodity down-streaming. Pre-election giveaways should support domestic demand in H1.

Inflationary pressures are set to be contained within the Bank Indonesia's (BI) target range, even if El Nino delays the 2024 rice harvest season. Nonetheless, the BI unexpectedly raised rates by 25bps in October and is projected to keep policy tight in H1 to offset the balance of payments-driven rupiah weakness. Unwarranted tight financial conditions are a risk to growth and productivity.

**Market Strategy**: The 12m forward P/E for MSCI Indonesia trades at a small premium to EM, similar to its five-year average. While we are constructive on Indonesia's economy as it moves up the manufacturing value chain, the upcoming elections could lead to political noise and volatility. As such, we reduce our *overweight* position.

### Philippines

*(Underweight)*

Restrictive monetary policy amid slowing growth and a twin deficit paint a negative economic backdrop, which does not bode well for a cyclically-tilted Philippine equity market (37% of the MSCI Philippines Index). High food inflation, notably rice, will keep headline inflation elevated. As such, the Bangko Sentral ng Pilipinas (BSP) will maintain its tightening bias. Unduly high lending rates will continue to weigh on credit growth and the economy.

The current account deficit, albeit set to narrow, means that the BSP will have to wait for the Fed before cutting rates to limit downward pressure on the peso. Nonetheless, the narrowing local bond yield differential to US Treasuries implies falling net debt portfolio inflows and, thereby, a weaker peso. Meanwhile, the government's infrastructure spending is positive for the medium term but will keep the budget deficit wide.

**Market Strategy**: Valuations for MSCI Philippines are relatively cheap compared to historical averages, with the 12m forward P/E premium to EM close to two standard deviations below its five-year average. While some negative news is likely priced in, we struggle to identify a positive catalyst to warrant a change in allocation. Thus, we keep our *underweight*.

## Thailand

*(Underweight)*

We are cautious on Thai stocks as the new government's digital wallet scheme risks endangering the country's fiscal position and stoking inflation. The program, worth c.3% of GDP, will hand out digital money to 50 million Thais to spend within a six-month period. Facing parliamentary and judicial hurdles, it is unlikely to pass until May. While providing a short-term boost to household spending, it will also widen the budget deficit and weaken the nation's structural debt position. Tourism is a bright spot as the Bank of Thailand (BoT) projects 35mn foreign visitors this year, helping keep the current account balance in a surplus.

Inflation has fallen sharply thanks to generous subsidies. Nonetheless, the BoT is set to keep rates on hold as it is mindful of cutting rates amid fiscal stimulus and high private debt levels.

Market Strategy: Valuations for the MSCI Thailand Index screen neutral on a relative 12m forward P/E basis vs EM but look expensive in absolute terms. We await the impact of the digital wallet scheme and stay underweight.

## Vietnam

*(Overweight)*

We maintain our optimistic view on Vietnam given that it should benefit from US-China decoupling and supply chain readjustment. In the near term, export growth should continue to slowly recover as external demand remains weak. While stable, the property sector is still soft as sentiment is low despite government measures to stabilize the sector. Other areas of domestic demand will fare better, given ample monetary and fiscal support. Contained inflationary pressures and a stable exchange rate have allowed authorities to keep monetary policy loose. Tourism also continues to recover.

On a structural basis, Vietnam is set to become an emerging manufacturing hub as supply chains shift in the wake of the US-China decoupling. FDI inflows into the manufacturing sector are on track to be higher in annual terms in FY23. Strong productivity gains have helped Vietnam increase its global export market share. The increase in the effective tax rate on multinationals to 15% is unlikely to deter FDI as tax incentives have not been the main driver of flows into Vietnam.

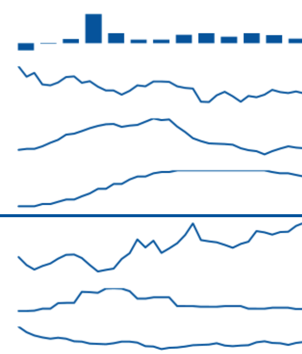
Market Strategy: The MSCI Vietnam Index appears cheap on a relative 12m forward P/E basis following the sell-off in Vietnamese equities in 2022. The market continues to look oversold, and longer-term fundamentals are robust. Therefore, we keep our overweight.

# Latin America

## Brazil

*Neutral*

*Concerns remain about Brazil's fiscal discipline, but medium-term drivers remain positive.*



| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 2.0 | Q3 |
| PMI, index | | 48.4 | Dec |
| CPI, % yoy | | 4.7 | Nov |
| Policy rate, % | | 11.75 | Dec |
| MSCI Brazil* | | 10.0% | Q4 |
| EPS, % yoy | | -21.2 | Dec |
| 12M Forward P/E | | 8.0 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

Brazilian equities outperformed the EM aggregate in 2023 and rose 17.8% in total return terms during Q4. Enthusiasm for the market has been partly predicated on the prospect of new fiscal reforms, which have recently passed the lower house and aim to revamp Brazil's complex tax code. But these reforms are only expected to be phased in over eight years, starting in 2026. History, as well as some recent evidence, suggests that investors should maintain a dose of scepticism towards the sustainability of fiscal discipline in Brazil. We expect public debt levels will continue to rise.

On a more optimistic note, some fiscal restraint has prevented a further rise in inflation expectations, allowing the central bank to start cutting interest rates. The Selic target rate is down 200bps since the middle of last year. With a low forward PE ratio of 8.0x, there is scope for the multiple to rise this year before fiscal issues return to the spotlight. Earnings projections are for 8% growth in 2024, supported by relatively solid commodity price trends from major exports such as iron ore. Commodities may benefit from an uptick in Chinese demand but are vulnerable if we see a global slowdown.

**Market Strategy**: The medium-term drivers have been supportive for Brazil, which is still trading at a relatively low P/E multiple. Still, we are cautious about a sustained rally given rising public debt and Brazil remains vulnerable to any commodity weakness. We remain *neutral*.

## Mexico

*Neutral*

*We are cautious on stocks given the upcoming US and Mexican elections and the possibility of a US slowdown.*

| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 3.3 | Q3 |
| PMI, index | | 52.0 | Dec |
| CPI, % yoy | | 4.3 | Nov |
| Policy rate, % | | 11.25 | Dec |
| MSCI Mexico* | | 10.7% | Q4 |
| EPS, % yoy | | -1.6 | Dec |
| 12M Forward P/E | | 13.3 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

The positive momentum in economic activity should continue into H1, with domestic demand holding up on the back of a tight labour market and robust remittances. However, growth is expected to moderate as the impact of prior monetary tightening feeds through and the US enters a likely slowdown. Pre-election giveaways and rate cuts from Banxico should provide some offset. Inflation has continued trending downwards, and markets are pricing the easing cycle to begin in Q1.

One of the key events in 2024 will be the general election. In the past four election cycles, Mexican equities have held steady in the six months ahead of the election. In June, voters will elect a new president, both upper and lower Congress members and state governors. The candidate for the ruling Morena party is leading in the polls, suggesting some political continuity. The widening budget deficit ahead of the election marks a change from the fiscal austerity of recent years and is a risk if not contained after the election. Elsewhere, the US election could hurt market sentiment if campaign rhetoric is negative toward Mexico.

The nearshoring trend is a long-term positive for Mexican equities. Foreign direct investment for Q1-Q3 has been weaker than 2022 but above the 20-year average. Both presidential candidates have expressed their support for nearshoring.

**Market Strategy**: Mexican stocks outperformed EM in Q4 as US rate cut expectations increased and markets rallied. As a result, the MSCI Mexico Index has started to look expensive, with the 12m forward P/E premium to EM above its five-year average. Earnings are expected to slow in 2024, and we are cautious of the negative spillover from a US slowdown. Additionally, the US and Mexican elections pose a political risk. We keep our *neutral* allocation as we are still optimistic on nearshoring.

# Europe, Middle East and Africa

## Turkey

*Underweight*

*Macroeconomic imbalances remain despite a return to orthodox monetary policy, while local elections are a risk.*

| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | 5.9 | Q3 |
| PMI, index | | 47.4 | Dec |
| CPI, % yoy | | 64.8 | Dec |
| Policy rate, % | | 42.50 | Dec |
| MSCI Turkey* | | -20.0% | Q4 |
| EPS, % yoy | | -3.5 | Dec |
| 12M Forward P/E | | 4.1 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

The MSCI Turkey Index underperformed EM in Q4 as the post-election optimism faded and tensions in the Middle East rose. Tighter monetary policy and the unwinding of unorthodox macro policy are starting to bear fruit as central bank net foreign assets have recovered. Moreover, foreign ownership of equities has ticked up from historic lows, suggesting improving investor sentiment. Nonetheless, with inflation proving to be sticky thus requiring more aggressive policy, we think it is too early to become positive on Turkey's stock market.

Headline inflation has gradually increased since June 2023 due to lira weakness and tax and wage hikes. The Central Bank of Turkey (CBT) projects inflation to trend higher in H1 2024 on the back of base effects. Despite elevated inflation expectations and a negative real policy rate, the CBT signalled that it was close to ending its tightening cycle at its December 2023 meeting. As such, achieving sustainable disinflation will prove challenging, especially in the context of expansionary fiscal stimulus ahead of local elections in March.

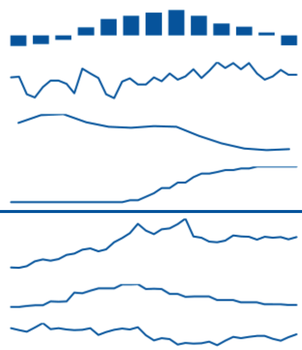
Economic activity, after holding up for the best part of 2023, is set to slow as the impact of tighter monetary policy feeds through. While GDP growth accelerated from 3.9% yoy in Q2 to 5.9% yoy in Q3, growth slowed sharply in sequential quarterly terms, implying a loss of momentum. Softer domestic demand should help narrow the current account deficit via weaker imports.

**Market Strategy**: Turkish stocks continue to trade at a discount. The 12m forward P/E is cheap on both a relative and absolute basis. In addition, the lira appears undervalued. We see limited value in changing our allocation ahead of local elections, which could see the incumbent AKP consolidate power and potentially weaken their resolve with orthodox policymaking. We stay *underweight*.

## Saudi Arabia

*Overweight*

*Soft oil prices are a risk to the budget, but we remain optimistic about structural reforms.*



| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | -4.4 | Q3 |
| PMI, index | | 57.5 | Dec |
| CPI, % yoy | | 1.7 | Nov |
| Policy rate, % | | 6.00 | Dec |
| MSCI Saudi Arabia* | | 1.0% | Q4 |
| EPS, % yoy | | -23.2 | Dec |
| 12M Forward P/E | | 17.3 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

The MSCI Saudi Arabia Index slightly outperformed EM in Q4 despite rising tensions in the Middle East, a weak oil price and a softer USD. Historically, a higher US dollar leads to Saudi equity outperformance relative to EM due to the Kingdom's dollar peg. Also, statistically, the dollar has a stronger relationship to the equity market than oil prices.

Following a likely contraction in 2023, GDP growth is projected to rise this year as oil output cuts are unwound. Saudi Arabia has rolled over its voluntary 1mbd production cut until end-Q1. Nonetheless, the non-oil economy will continue to be the main driver of economic activity. Private consumption and investment are strong, reflecting the spillover from the Kingdom's structural reforms. In addition, with inflationary pressures muted, authorities should start easing policy in line with the Fed.

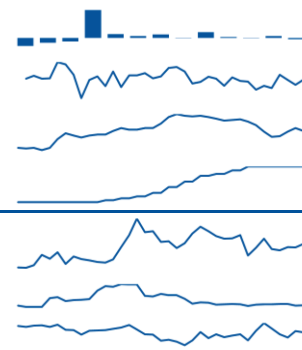
Lower oil production and ambitious public spending have caused a rise in the breakeven oil price, estimated at $85.8/bbl by the IMF. As such, the government is projecting moderate budget deficits out to 2026. The budget gap is likely to be plugged by debt. With public debt under 30% of GDP, the Kingdom's fiscal situation is not yet alarming. On the external position, the current account surplus should narrow on the back of higher imports from fiscal spending.

**Market Strategy**: Valuations for Saudi Arabia's stock market screen neutral. The 12m forward P/E premium to EM is in line with its five-year average. While it is one of the most expensive EMs, projections point to double-digit earnings growth in 2024. Moreover, Saudi stocks are still under-owned by GEM funds. As such, there is an opportunity for stock prices to rise as flows increase. We continue to see positive developments from the reform programme and remain *overweight*.

## South Africa

*Underweight*

*Upcoming elections will delay much-needed reforms to address South Africa's ailing logistics and energy sector.*



| | 3Y history | Latest | |
|---|---|---|---|
| GDP, % yoy | | -0.7 | Q3 |
| PMI, index | | 50.0 | Nov |
| CPI, % yoy | | 5.5 | Nov |
| Policy rate, % | | 8.25 | Dec |
| MSCI South Africa* | | 4.7% | Q4 |
| EPS, % yoy | | -20.4 | Dec |
| 12M Forward P/E | | 9.8 | Dec |

**US$ total return relative to MSCI EM.* *Source: Bloomberg*

South Africa's near-term outlook is clouded by structural issues such as the energy crisis and logistics disruptions, which have weighed on the country's external and budget balance. While the intensity of power outages will likely ease this year as the Kusile power station returns to service and private generation increases, load shedding will remain a problem, dragging on confidence and productivity. Elsewhere, the inefficiencies behind the port and rail system are more challenging to resolve in the short term.

The speed at which South Africa's structural problems are addressed depends on the general election results. The incumbent ANC is set to lose its majority for the first time in three decades, forcing it to form a coalition. A coalition made up of the ANC and smaller parties outside the major opposition parties (DA and EFF) is more favourable than the ANC teaming up with the radical EFF. Nonetheless, without a majority, the ANC will unlikely press ahead with much-needed structural reforms.

Inflation has been edging down, but the risks are skewed to the upside due to El Niño-related food prices and a softer rand. As such, the market is pricing in the South African Reserve Bank (SARB) to start cutting rates in H2, permitted rand weakness is limited.

**Market Strategy**: Valuations for MSCI South Africa are neutral, with the 12m forward P/E trading at a discount to EM in line with its five-year average. Market volatility ahead of the election and ongoing structural problems mean that there are downside risks to earnings. Additionally, the widening fiscal deficit and lack of plans for fiscal consolidation raise the country's risk premium. Therefore, we maintain our *underweight*.

# KEY ECONOMIC AND FINANCIAL INDICATORS

| | | Macroeconomic Data | | | | | | | | | | | Market Data | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | % change on year ago | | | Latest 12 months | | | | | | | | Performance | | | | Forecast (Bloomberg)† | | | |
| | Emerging Market | Annual GDP Growth* | Industrial Production* | Consumer Price Index* | Trade Balance* | Current Account Balance* | Foreign Reserves 2023 Latest* | Foreign Reserves 2022 Year ago | Currency vs $ 2024 Latest* | Currency vs $ 2023 Year ago | Short-Term Interest Rates* | Sovereign Rating S&P* | % S&P/EM Frontier Super Composite BMI | Stock Market Index S&P/EM Front. Super Comp. BMI US$ | Change since 12/30/22 US$ | Change since 12/30/22 Local Currency | 2023 P/E Forecast* | EBIT Margin 2023 Forecast* | 6 month Stock Market Index Estimate (Front. Super Comp. BMI) US$* | 3 month Currency vs $ +/-* |
| | | % | % | % | $ Bn | $ Bn | $ Bn | $ Bn | | | % | | Dec. 29, 2023 | Dec. 29, 2023 | % | % | | % | | |
| Overweight | VIETNAM | 6.7 | 5.8 | 3.6 | 27.7 | 27.4 | 87.2 | 84.1 | 24363.0 | 23508.0 | 4.2 | BB+ | 0.3 | 225.6 | 16.2 | 19.6 | 16.1 | 15.0 | 235.1 | + |
| | TAIWAN | 2.3 | -2.5 | 2.7 | 74.2 | 91.8 | 570.6 | 554.9 | 31.0 | 30.7 | 1.5 | AA+ | 16.0 | 559.2 | 32.2 | 32.0 | 18.9 | 9.5 | 178.0 | - |
| | INDONESIA | 4.9 | -1.9 | 2.6 | 36.1 | 3.6 | 119.8 | 117.9 | 15503.0 | 15624.0 | 4.2 | BBB | 1.9 | 1432.7 | 5.9 | 4.7 | 15.1 | 24.6 | 1495.9 | + |
| | SAUDI ARABIA | -4.4 | n.a. | 1.7 | 35.8 | 5.0 | 402.1 | 433.1 | 3.8 | 3.8 | 5.7 | A | 3.6 | 176.6 | 14.8 | 14.6 | 20.3 | 30.7 | 180.0 | uc |
| | CHILE | 0.6 | 2.7 | 4.8 | 15.9 | -11.1 | 37.4 | 34.0 | 891.5 | 854.5 | 8.6 | A | 0.5 | 418.6 | 8.1 | 10.8 | 10.5 | 13.0 | 424.7 | + |
| | MALAYSIA | 3.3 | 2.7 | 1.5 | 50.9 | 11.1 | 103.0 | 100.8 | 4.7 | 4.4 | 2.6 | A- | 1.6 | 364.2 | 1.1 | 5.4 | 15.5 | 20.9 | 378.9 | + |
| | QATAR | 1.0 | n.a. | 1.3 | 84.9 | 55.4 | 43.0 | 38.0 | 3.6 | 3.7 | n.a. | AA | 0.8 | 307.8 | 2.2 | 2.2 | 10.5 | n.a. | 314.9 | uc |
| Neutral | BAHRAIN | 2.5 | n.a. | -0.4 | n.a. | n.a. | 4.4 | 4.3 | 0.4 | 0.4 | 6.2 | B+ | 0.1 | 324.3 | 23.4 | 21.5 | n.a. | n.a. | 332.0 | uc |
| | BRAZIL | 2.0 | 1.3 | 4.7 | 94.3 | -33.7 | 316.7 | 301.3 | 4.9 | 5.4 | 7.5 | BB | 5.5 | 858.9 | 35.7 | 25.3 | 8.7 | 20.9 | 886.8 | - |
| | CHINA | 4.9 | 6.6 | -0.5 | 811.9 | 312.2 | 3160.1 | 3054.9 | 7.1 | 6.9 | 1.1 | A+ | 24.1 | 675.1 | -10.6 | -10.1 | 10.5 | 12.6 | 691.5 | + |
| | COLOMBIA | -0.3 | -2.2 | 10.2 | -10.7 | -11.8 | 52.7 | 51.6 | 3905.1 | 4967.0 | 12.2 | BB+ | 0.1 | 5170.5 | 21.6 | -2.1 | 5.4 | 31.3 | 5238.6 | - |
| | CZECH REP. | -0.8 | 8.0 | 7.3 | 2.8 | -2.0 | 134.4 | 132.5 | 22.4 | 22.9 | 6.4 | AA- | 0.1 | 1547.4 | 31.2 | 29.6 | 11.9 | n.a. | 1602.4 | - |
| | EGYPT | 6.7 | -10.1 | 34.6 | -32.1 | -4.7 | 24.9 | 24.3 | 30.8 | 27.1 | 19.3 | B- | 0.1 | 1895.7 | 46.8 | 83.5 | 8.4 | n.a. | 2252.6 | - |
| | GREECE | 2.1 | 10.5 | 3.0 | -36.1 | -16.2 | 4.1 | 3.3 | 1.1 | 1.1 | 0.0 | BBB- | 0.5 | 55.0 | 48.9 | 44.3 | 6.9 | 23.4 | 56.6 | - |
| | HUNGARY | -0.4 | -2.8 | 7.9 | 10.1 | -4.3 | 35.6 | 30.7 | 343.7 | 375.9 | 9.5 | BBB- | 0.2 | 690.0 | 53.7 | 41.8 | 5.0 | n.a. | 57.5 | - |
| | KUWAIT | 8.9 | n.a. | 3.8 | n.a. | 63.2 | 39.9 | 39.4 | 0.3 | 0.3 | 4.5 | A+ | 0.7 | 133.4 | -6.3 | -5.9 | 14.9 | n.a. | 136.4 | |
| | MEXICO | 3.3 | 5.5 | 4.3 | -8.7 | -70.0 | 183.6 | 176.4 | 16.9 | 19.3 | 11.5 | BBB | 2.3 | 708.7 | 41.5 | 23.2 | 13.9 | 17.0 | 744.4 | - |
| | MOROCCO | 2.8 | -3.5 | 3.6 | -16.8 | -1.3 | 31.1 | 27.9 | 9.9 | 10.4 | 2.9 | BB+ | 0.2 | 654.6 | 21.8 | 13.3 | 18.0 | 23.6 | 676.9 | |
| | NIGERIA | 2.5 | n.a. | 28.2 | 6.9 | 6.0 | 28.7 | 33.3 | 930.3 | 461.0 | 9.0 | B- | 0.1 | 165.0 | -6.3 | 56.4 | 5.1 | n.a. | 448.5 | + |
| | PERU | -1.0 | -0.8 | 3.2 | 15.4 | -1.9 | 68.7 | 71.9 | 3.7 | 3.8 | 0.2 | BBB | 0.2 | 2379.0 | 34.9 | 34.5 | 14.1 | n.a. | 456.3 | - |
| | POLAND | 0.5 | -0.7 | 6.1 | 5.5 | 7.5 | 156.1 | 142.5 | 4.0 | 4.4 | 6.1 | A- | 0.9 | 409.9 | 52.9 | 37.4 | 7.9 | 14.7 | 419.1 | - |
| | ROMANIA | 1.1 | -4.9 | 6.7 | -31.0 | -23.0 | 61.0 | 43.7 | 4.5 | 4.7 | 6.1 | BBB- | 0.1 | 250.4 | 45.7 | 41.6 | 7.8 | 27.3 | 262.0 | - |
| | SOUTH KOREA | 1.4 | 5.3 | 3.2 | -10.0 | 25.8 | 388.9 | 390.6 | 1311.0 | 1276.9 | 3.8 | AA | 12.3 | 613.2 | 23.6 | 25.8 | 18.3 | 6.8 | 177.3 | + |
| | UAE | 7.9 | n.a. | 2.3 | 79.0 | 48.0 | 158.0 | 112.1 | 3.7 | 3.7 | 2.9 | NR | 1.4 | 177.5 | 4.1 | 4.1 | 9.0 | n.a. | 182.3 | uc |
| Underweight | ARGENTINA | -0.8 | -13.3 | 160.9 | -6.9 | -16.5 | 17.5 | 32.2 | 812.3 | 178.9 | 106.9 | CCC- | 0.9 | 1440.7 | 81.7 | 729.4 | 13.8 | 23.2 | 1453.2 | - |
| | TURKEY | 5.9 | 1.1 | 64.8 | -109.6 | -50.7 | 69.3 | 62.1 | 29.8 | 18.8 | 53.2 | B | 0.9 | 420.9 | -9.9 | 42.0 | 4.9 | 15.7 | 454.8 | - |
| | PHILIPPINES | 5.9 | 1.7 | 3.9 | -52.3 | -10.4 | 86.0 | 81.4 | 55.5 | 55.9 | 6.5 | BBB+ | 0.7 | 722.6 | 1.2 | 0.6 | 12.8 | 23.4 | 2488.9 | + |
| | THAILAND | 1.5 | -4.7 | -0.8 | 16.0 | 5.3 | 196.4 | 190.2 | 34.5 | 34.1 | 2.1 | BBB+ | 1.8 | 1168.7 | -12.3 | -13.6 | 19.0 | 9.3 | 576.1 | - |
| | SOUTH AFRICA | -0.7 | 2.1 | 5.5 | 3.0 | -23.6 | 46.8 | 46.1 | 18.6 | 17.2 | 8.8 | BB- | 2.6 | 747.2 | 0.7 | 8.2 | 14.2 | 21.1 | 767.4 | - |
| | INDIA | 7.6 | 11.7 | 5.6 | -252.4 | -35.6 | 519.3 | 474.1 | 83.1 | 82.6 | 6.5 | BBB- | 18.4 | 2011.5 | 26.4 | 27.1 | 26.0 | 13.4 | 2112.0 | - |

*Note: All data shown are as at 9 October 2023 unless stated otherwise. UC is unchanged (currency versus US dollar). S&P sovereign rating shown is long-term foreign currency rating. Data for countries in the Middle East and North Africa region are the latest available, but in certain cases relate to periods more than one year ago. The 30 countries shown in the table accounted for 98.8% of the S&P/EM Frontier Super Composite BMI on 30 June 2023. An additional 26 countries accounted for the remaining 1.2% of the index on the same date. These countries, which can be accessed via City of London's Frontier Markets strategy, are: Bangladesh, Botswana, Bulgaria, Cote d'Ivoire, Croatia, Cyprus, Estonia, Ghana, Iceland, Jamaica, Jordan, Kazakhstan, Kenya, Latvia, Lithuania, Mauritius, Namibia, Oman, Pakistan, Panama, Slovakia, Slovenia, Sri Lanka, Trinidad & Tobago, Tunisia and Zambia.*

*†Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.*

**Key Criteria*

*Source: Bloomberg, CLIM*

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