CITY OF LONDON
Investment Management Company Limited

Emerging Markets Quarterly Outlook

October 2023*

Overview

A Perfect Storm

Emerging market equities faced a perfect storm of negative drivers this past quarter, including higher bond yields, a stronger US dollar, and rising oil prices. While challenges remain for global equities, particularly following the Federal Reserve's aggressive monetary tightening cycle, EM is well placed for a rerating once US rates peak and the global semiconductor recovery gathers steam. In addition, we now see Chinese equity risks as more balanced, given recent improvements in activity data and cheap valuations.

Emerging market (EM) equities traded lower over the quarter but performed roughly in line with international equities (MSCI World ex-US Index). EM assets had to contend with a perfect storm, including higher long-term bond yields, a stronger US dollar, and rising oil prices in response to supply cuts. These headwinds added to existing ones, such as a tighter monetary policy cycle in the US and Europe and elevated geopolitical risks (e.g., US-China tensions). Overall, the global drivers remained unfavourable for EM equities in recent weeks, which may continue to present challenges in Q4. However, we expect some of these short-term factors to moderate or reverse over the medium term.

Looking beyond the recent volatility, earnings estimates for the MSCI EM Index are +19% yoy in 2024. Should these estimates materialise, we think the index's current 11x multiple is too conservative, pricing an outlook more consistent with negative or flat earnings growth persisting into next year. Current EM forward earnings estimates will likely be subject to downward revisions, particularly if a global slowdown/recession occurs in 2024. However, the present P/E multiple leaves EM equities well-positioned to benefit from an eventual peak in the Fed's hiking cycle and a recovery in global semiconductor sales.

China, the largest index constituent, continues to navigate structural growth challenges, a slowing property sector, and geopolitical risks. However, recent data is presenting a slightly more optimistic cyclical trend. The Citi Economic Surprise Index for China has started to revert closer to zero in recent weeks, while retail and industrial activity data series are exhibiting early evidence of a trough in economic activity. In addition, the forward P/E multiple trades at a steep 17% discount to the broader EM equity market, similar to previous lows in 2022. Given these factors, we now see the risks as more balanced for Chinese stocks.

In other parts of EM, our country allocation continues to tilt towards key thematic drivers over the next year. Our overweight allocation to Taiwan should benefit from long-term adoption of Artificial Intelligence (AI) and resulting demand for advanced chips. In addition, broader global semiconductor sales are already showing signs of a gradual recovery from the downcycle starting in 2022. Global/US supply-chain readjustment remains a key long-term theme. We are overweight Vietnam, Indonesia, and Malaysia to benefit from these trends. India remains a potential beneficiary of US manufacturing shifting away from China. Still, we remain concerned that the equity market is already pricing this optimism at a 20x multiple while the monetary cycle remains a potential headwind for growth. In the commodity space, we remain overweight Saudi Arabia. Diversification efforts in the non-oil economy remain supportive, while oil prices are expected to remain elevated. In South Africa, we stay underweight due to ongoing power supply issues that continue to weigh on the domestic economy.

Market Strategy: Our EM allocation continues to focus on strategic opportunities such as advanced semiconductor demand, supply-chain readjustment, and the renewable energy transition. Relative to the previous quarter, we make the following adjustment to the existing country allocations:

- We upgrade **China** to *neutral*. Sentiment remains negative in equity market pricing, as reflected in the steep equity market discount relative to the broader MSCI EM Index. However, we now see reasonable evidence that recent policy measures and improving activity data are forming a cyclical bottom, which should reduce investor pessimism. A neutral allocation is prudent due to a more balanced risk assessment over the coming months. Our existing positions are adjusted to accommodate the allocation upgrade to China.

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. *Source: CLIM*

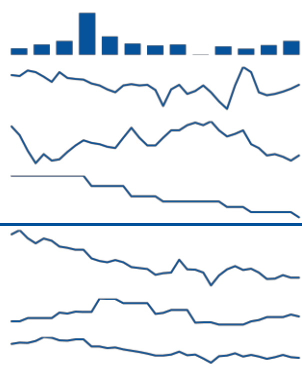
The publication reflects asset performance up to 29 September 2023, and macro events and data releases up to 9 October 2023, unless indicated otherwise.

Asia

China

Neutral (↑)

Negative sentiment and economic weakness appear to have troughed.

	3Y history	Latest	
GDP, % yoy		6.3	Q2
PMI, index		50.2	Sep
CPI, % yoy		0.1	Aug
Policy rate, %*		10.50	Sep
MSCI China**		1.0%	Q3
EPS, % yoy		-7.3	Sep
12M Forward P/E		9.8	Sep

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

The Chinese economy has underperformed expectations since it reopened, as have equities. However, Chinese policymakers have begun to make small stimulative, targeted changes, which are beginning to feed into activity data. In addition, we expect policy to remain loose to help stabilise and improve business and consumer confidence. This shift is coming at a point of depressed sentiment with the P/E ratio at 9.8x, below its 5y average of 12.1x. The combination of improving activity and cheap valuations indicates that the risks have become more balanced for the equity market.

Despite structural growth challenges, China's economy is still one of the world's fastest growing. The slowing pace concerns policymakers and external investors; however, the economy still offers long-term potential. China has a large consumer market with a growing appetite for higher-end goods such as electric vehicles, clothing, and smartphones. In addition, its innovative tech industry remains a global contender in the growing generative AI space. China also does not have the same inflationary problems that many other economies face, allowing the central bank to maintain easier monetary policy.

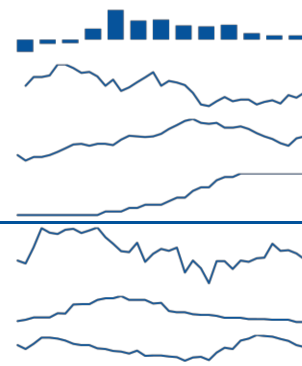
There are still several reasons as to why we are wary of China. Historically, its property sector has been the primary growth engine and continues to weaken. In addition, while economic growth may stabilise, confidence remains weak and will require additional political will to reignite animal spirits. Geopolitics also remain a risk that will limit foreign investment until the US and China establish better guardrails for strategic competition.

Market Strategy: Chinese equities are trading cheaply, while economic data appears to be reaching a trough following various policy measures. We assess that the risk distribution has become more balanced. For these reasons, we upgrade China to *neutral.*

South Korea

Neutral

Korea's exposure to semiconductors is a long-term opportunity but a shorter-term cyclical risk.

	3Y history	Latest	
GDP, % yoy		0.9	Q2
PMI, index		49.9	Sep
CPI, % yoy		3.7	Sep
Policy rate, %		3.50	Sep
MSCI South Korea*		-3.7%	Q3
EPS, % yoy		-47.2	Sep
12M Forward P/E		11.1	Sep

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

MSCI Korea fell 6.6% during the three months to end of September, underperforming the EM index. Korean equities are trading at a PE ratio of 11.4x, down from the peak of 14.4x in April, but above its five-year average and above the EM average.

The Korean equity index, as with Taiwan, has a high weighting to semiconductor manufacturing and offers a picks-and-shovels play on developments in AI and other advanced technologies. There are signs that the semiconductor cycle may have bottomed, and DRAM and NAND prices – in which Korea has a significant presence in manufacturing – also appear to have bottomed.

The Korean economy is cyclical, which is a concern given the risk of a global economic slowdown. Growth has been relatively weak, and the Manufacturing PMI has been below 50 for over a year. Still, the data suggests that even if there is a further fall in the local economy, it need not be reflected in the equity market, which is more exposed to the global semiconductor cycle.

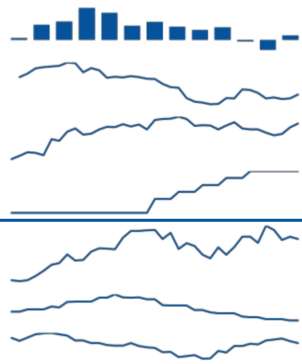
The Bank of Korea has not changed rates since January and seems content to stand by as inflation increases slightly due to supply issues, such as the rising oil price. Expectations are that a hawkish hold will likely continue for the coming months.

Market Strategy: We remain *neutral* on Korea. The relatively high multiples are a concern, as is the cyclical nature of the index. Yet the market has a significant weight in sectors likely to benefit from further developments in areas such as AI. In addition, the broader chips cycle is already bottoming following a downcycle starting in 2022.

Taiwan

Overweight

Taiwan's position in the advanced semiconductor industry is a strength.



	3Y history	Latest	
GDP, % yoy		1.4	Q2
PMI, index		46.4	Sep
CPI, % yoy		2.9	Sep
Policy rate, %		1.88	Sep
MSCI Taiwan*		-4.5%	Q3
EPS, % yoy		-29.6	Sep
12M Forward P/E		15.0	Sep

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

The Taiwanese equity market has a large weighting to semiconductor manufacturers and other areas of advanced technology. The semiconductor cycle has been weak in recent periods, and the recovery may be slow, particularly if we see a global economic slowdown. Still, we remain optimistic about the sector's long-term prospects due to the growing demand for advanced chips to power AI innovations. Taiwan is well placed to capitalise on this trend.

The Taiwanese presidential election in January 2024 is a significant event, potentially having critical geopolitical ramifications. If the incumbent, more pro-independence Democratic Progressive (DPP) party are re-elected ahead of the more Beijing-friendly Kuomintang (KMT) party, the market might view this less favourably. The status quo result may heighten tensions along the Taiwan Strait. Although a significant fracture on this geopolitical front, whether militarily or economically, seems relatively remote, the possibility still needs to be accounted for.

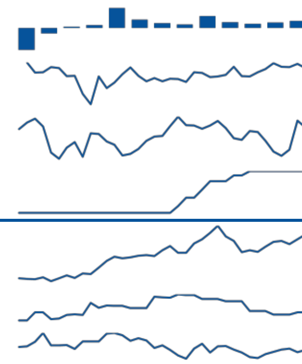
Valuations are relatively expensive in Taiwan – with the PE ratio at the end of September at 15.1x. This is above the EM average and around one standard deviation above the historical average for Taiwan. It is down from the end-June reading of 16.0x and below the recent high of 16.6x during the second quarter. Returns have been disappointing, with the total return index falling 7.4% in the three months to end-September.

Market Strategy: We remain *overweight* Taiwanese equities, judging that the potential for growth in the tech-heavy index justifies above-average valuations.

India

Underweight

India's growth prospects remain attractive, but the equity market is expensive.



	3Y history	Latest	
GDP, % yoy		7.8	Q2
PMI, index		57.5	Sep
CPI, % yoy		6.8	Aug
Policy rate, %		6.50	Sep
MSCI India*		5.6%	Q3
EPS, % yoy		-0.5	Sep
12M Forward P/E		20.4	Sep

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

Indian equities have performed well in recent months despite appearing richly valued. The P/E ratio was 20.4x at the end of September. At this level, valuations remain above the EM average and India's historical norms, though down from their late-2022 peak. In the longer term, we are optimistic about India for several reasons, including its favourable demographics and stable politics. However, the higher multiple already reflects a more optimistic future growth environment.

Historically, rising oil prices have been a negative for Indian equities. This relationship is less robust than it was in the years before the Covid pandemic. Still, India remains a significant oil importer and higher energy costs may start to drag on the economy, particularly if they rise much further. Monetary policy remains tight, potentially restricting credit and economic growth.

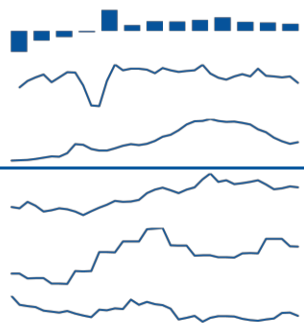
Indian food inflation has been a concern lately due to low levels of rainfall, which, given food's 45% weight in the headline inflation measure, is a significant cost for consumers. Dissatisfaction at these rises has turned political and could affect next year's elections.

Market Strategy: There has been noticeable correlation with US equities in recent years. A top in global equity markets will likely weigh on Indian stocks. Given global headwinds, combined with shorter-term domestic challenges and rich valuations, we remain *underweight* Indian equities.

ASEAN

We favour exposure to nearshoring trends via ASEAN equities due to their stable governance and attractive valuations.

	3Y history	Latest	
GDP, % yoy*		4.1	Q2
PMI, index		49.6	Sep
CPI, % yoy		3.0	Aug
MSCI ASEAN**		1.4%	Q3
EPS, % yoy		11.8	Sep
12M Forward P/E		13.5	Sep



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

The near-term outlook is challenging for ASEAN economies, given their sensitivity to the global cycle. Moreover, food price inflation is still a significant risk in places like Thailand and the Philippines. However, green shoots in China's economy are emerging as the downturn appears to be bottoming out. After rate hikes in response to inflation, ASEAN economies have built up policy space that can be used to combat the global slowdown. Beyond the near term, the region is well placed to benefit from US-China decoupling. Combined with its stable governance, low geopolitical risk, and attractive valuations, we remain optimistic about the bloc.

Malaysia

(Overweight)

While Malaysia's economic backdrop is one of the softest in the region, we still favour MSCI Malaysia, given its defensive tilt, making it well placed to weather a global slowdown. Over the medium term, expanding Malaysia's semiconductor sector is a priority within the government's 10-year economic plan. On politics, the conclusion of state elections removes imminent political uncertainty, as the legislature was evenly split between the incumbent coalition and opposition as expected, allowing PM Anwar Ibrahim to roll out previously announced policies. However, the fact that Ibrahim's coalition failed to consolidate power puts pressure on the government to stimulate the economy and shore up support ahead of the 2027 general election.

Growth in the near term will be hindered by slowing external demand, fiscal consolidation and prior monetary tightening. The Bank Negara Malaysia (BNM) has maintained the policy rate at 3% on the back of cooling inflation. Still, anticipated fuel subsidy reform and El Niño mean that the risks to inflation are skewed to the upside. As such, the BNM is more likely to hike rather than cut over the coming months.

Market Strategy: Valuations for Malaysia's stock market marginally deteriorated over the last three months but still appear attractive, with the forward P/E premium over EM in line with its five-year average. Earnings have been downgraded but are still expected to post minor gains. We maintain our *overweight*.

Indonesia

(Overweight)

Indonesia remains a bright spot in ASEAN as it focuses on enhancing its EV battery supply chain. As such, we look through near-term weakness in the external balance on the back of softer coal and palm oil prices. Meanwhile, while inflation might tick up due to rice inflation, it will likely remain within the Bank Indonesia's (BI) target range of 1.5-3.5%. Nonetheless, balance of payments pressures will push back the BI's first rate cut to early 2024.

The general election in February is a potential risk to Indonesia's structural reform agenda. The fact that the top three contenders are a part of the ruling coalition suggests some political continuity and limited change to the current prudent fiscal and monetary regime. However, a seamless transition is far from certain; therefore, market volatility could increase in the lead-up to the election.

Market Strategy: Indonesia's equity market valuations have not changed and continue to screen neutral. Earnings for 2023 and 2024 point to healthy growth. We keep our *overweight*.

Philippines

(Underweight)

The outlook for the domestic monetary policy does not bode well for the Philippines' equity market, which is cyclically tilted (38.6% of the index). Indeed, following one of the most hawkish tightening cycles in the region, rising inflation due to food and transport prices will keep the Bangko Sentral ng Pilipinas (BSP) cautious, potentially leading to an off-cycle hike. Moreover, El Niño is a risk to rice prices, which has a c.9% weight in the CPI basket.

Meanwhile, a current account deficit means the BSP will wait for the Fed before cutting rates. With the yield differential relative to US Treasuries narrowing, net debt portfolio inflows will retreat, suggesting a floor under Philippine bond yields. As such, the boost to equities from the likely peak in the Philippine policy rate will be limited.

Market Strategy: The MSCI Philippines' valuation appears cheap, with the forward P/E premium to EM two standard deviations below its five-year average. Earnings are expected to grow a robust 9.3% in 2024 after an estimated 33.2% this year. But with prior monetary tightening still working its way through the real economy and BSP's hawkish bias, there is scope for downside revisions. Therefore, we stay *underweight*.

Thailand

(Underweight)

The tepid recovery in tourist arrivals from China and ongoing political uncertainty keeps us cautious on Thai stocks. On the former, as of August, Chinese visitors to Thailand had only recovered to 38.8% of 2019 levels, behind other ASEAN markets. The pace of recovery should pick up following the recent visa requirement waiver for travel between September 2023 and February 2024, as indicated by the surge in Chinese outbound flights in October.

On the political front, while a new Prime Minister reduces some uncertainty, the Pheu Thai-led coalition comprises opposing parties. The absence of a positive market reaction to the new PM could suggest that there is still a lingering risk of political upheaval as the opposition Move Forward Party, who won the most votes, was blocked from forming a government. The new government has promised fiscal giveaways that should support growth while widening the budget deficit and risking stoking inflation. Nonetheless, the Bank of Thailand (BoT) appears to be done with its tightening cycle.

Market Strategy: The MSCI Thailand Index continues to trade at a premium to EM in line with its five-year average. In absolute terms, its forward P/E multiple of 16.1x is the highest in ASEAN. We see better opportunities in other parts of ASEAN. We remain *underweight*.

Vietnam

(Overweight)

We remain optimistic about Vietnam's structural story as it benefits from US-China decoupling and supply chain readjustment. Indeed, US-Vietnam relations were upgraded in September to the Comprehensive Strategic Partnership level, focusing on semiconductors. Moreover, while other economic activity has been soft this year, manufacturing FDI has been resilient.

In the near term, however, Vietnam's economy faces headwinds in the form of slowing external demand and a fragile real estate sector, which accounts for 34% of the MSCI index. Given these factors, monetary and fiscal policy are likely to stay expansionary. El Niño-related food prices are a risk to inflation, but core inflation should remain muted on soft domestic demand.

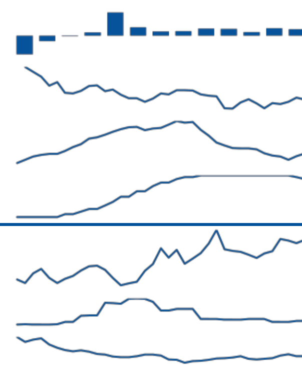
Market Strategy: The sharp sell-off in Vietnamese equities in the past two months has improved valuation measures. The MSCI Vietnam Index fell by 12% in US dollar terms since its peak in early-September over fears that the State Bank of Vietnam (SBV) was tightening policy and on weak regional sentiment. The market now looks oversold, and we still see long-term value in Vietnam's equity market from nearshoring trends and, therefore, maintain our *overweight* allocation.

Latin America

Brazil

Neutral

We expect some positive drivers to fade over the medium term.



	3Y history	Latest	
GDP, % yoy		3.4	Q2
PMI, index		49.0	Sep
CPI, % yoy		4.6	Aug
Policy rate, %		12.75	Sep
MSCI Brazil*		-0.7%	Q3
EPS, % yoy		-9.8	Sep
12M Forward P/E		7.7	Sep

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

Brazilian equities have been one of the stronger markets year-to-date but have underperformed the broader EM index in the most recent quarter. Recent returns have been against a backdrop of apparently deteriorating macro conditions; the aggregate PMI has fallen in recent months, inflation expectations remain elevated, public debt is rising, and tax revenue is below expectations.

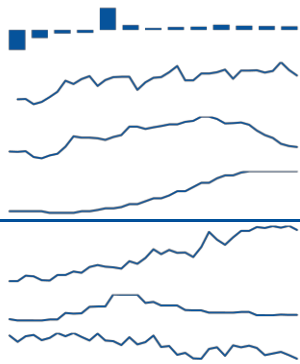
Several factors have been behind the positive year-to-date performance, including a boost to confidence over the proposed tax reforms. These reforms have now passed in the lower house and are expected to pass in the Senate. Brazil's tax code would benefit from reform, but these reforms will likely take years to enact and seem to have an outsized impact on the near-term expectations. The rise in commodity prices has also benefitted Brazil, particularly iron ore, up over 20% in the past 12 months. These have supported the economy and may continue to do so. Although commodity prices may rise further, they are vulnerable to a potential economic downturn. Another supporting factor is that the Brazilian central bank has cut rates by 50bp twice in recent months. This easing of monetary policy provides a tailwind for equities.

Market Strategy: We remain *neutral* on Brazilian equities. Several areas remain concerning in the longer term, including rising public debt levels. However, we are cognizant that some shorter-term positive drivers may persist over the coming months while valuations remain relatively attractive.

Mexico

Neutral

While nearshoring is a long-term positive, political risks from US elections and AMLO's policies keep us cautious.



	3Y history	Latest	
GDP, % yoy		3.6	Q2
PMI, index		49.8	Sep
CPI, % yoy		4.6	Aug
Policy rate, %		11.25	Sep
MSCI Mexico*		-3.6%	Q3
EPS, % yoy		4.9	Sep
12M Forward P/E		11.2	Sep

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

Mexican stocks underperformed EM in Q3, reversing the past year's trend. Domestic demand has proven resilient due to low unemployment and strong remittances, while nearshoring trends have supported investment. FDI reached just over $29bn in H1, weaker than last year's outturn but still the third highest H1 on record.

Headline inflation has been edging down; however, core inflation is still elevated at 6.1%. Sticky core price pressures due to strong domestic demand will likely keep the Banxico cautious about when it starts its easing cycle. The market is pricing in a more conservative cutting cycle than elsewhere in Latin America.

Polls for next year's general election point to the incumbent MORENA retaining power, suggesting policy continuity. Nonetheless, there is a risk that if MORENA increases its seats in Congress, it could push for greater fiscal spending. The 2024 Budget set out a sharper widening of the fiscal deficit than expected, suggesting growth was being favoured over fiscal prudence. Higher government spending would add to inflationary pressures, further complicating Banxico's task.

A US slowdown is the leading risk for Mexico, given the proximity of the two economies. In addition, tensions between the two could rise ahead of the US elections over issues such as immigration, hampering Mexico's nearshoring efforts.

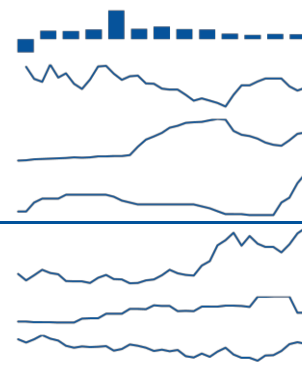
Market Strategy: Despite the rally, the MSCI Mexico Index looks cheap, with the 12m forward P/E multiple trading at a small discount to EM and over one standard deviation below its five-year average. Yet a slowdown and elections in the US are key risks to the outlook. Moreover, we are still cautious for the potential of business-unfriendly government policies, as demonstrated by the recent change to airline concession agreements. We keep our *neutral* allocation.

Europe, Middle East and Africa

Turkey

Underweight

The new economic team have been slow and not forceful enough in correcting macroeconomic imbalances.



	3Y history	Latest	
GDP, % yoy		3.8	Q2
PMI, index		49.6	Sep
CPI, % yoy		61.5	Sep
Policy rate, %		30.00	Sep
MSCI Turkey*		35.6%	Q3
EPS, % yoy		35.4	Sep
12M Forward P/E		5.5	Sep

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

The rally in Turkish equities continued apace in Q3 as moves by the new economic team have been perceived to be a return to orthodox policymaking. However, we think that policymakers have not been addressing macroeconomic imbalances at a fast enough pace. It is telling that foreign equity holdings are still below 30%, suggesting investor caution around Turkey's post-election economic policy framework.

Under the helm of a new governor, the central bank has increased rates by more than 20 percentage points from 8.5% to 30% as it tries to cool domestic demand fuelled by loose policy. Tighter financial conditions should weigh on private consumption, removing a key source of economic growth. Indeed, lira credit growth slowed sharply in Q3. However, the surge in Brent crude prices and lira weakness point to a reversal in the disinflation process. Headline inflation jumped to 61.5% in September and is likely to trend higher. As such, the market is pricing in a further 10%pts of rate hikes in the next six months. This would still leave real rates deeply negative, putting downward pressure on the lira.

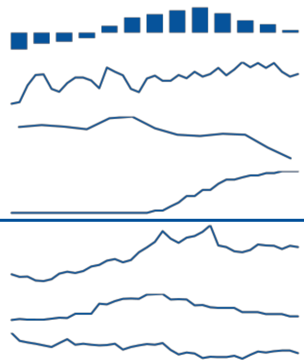
The government's Medium-term Program (2024-2026) foresees a gradual narrowing of the budget and current account deficit over the coming years, which will be challenging to achieve in the context of negative real rates. In addition, the program was light on details on structural reform.

Market Strategy: Despite the post-election rally, Turkish stocks trade at a large discount. At a 12m forward P/E multiple of 5.6x, it is one of the cheapest markets in EM. We do not expect this relative ranking to change. While authorities have taken steps in the right direction, we are sceptical that the new economic team will be able to push through painful economic policies to address macro imbalances. Therefore, we keep our *underweight*.

Saudi Arabia

Overweight

We maintain our positive view as the Kingdom makes head-way with its structural reforms.



	3Y history	Latest	
GDP, % yoy		1.2	Q2
PMI, index		57.2	Sep
CPI, % yoy		2.0	Aug
Policy rate, %		6.00	Sep
MSCI Saudi Arabia*		-1.5%	Q3
EPS, % yoy		-16.9	Sep
12M Forward P/E		15.9	Sep

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

The MSCI Saudi Arabia Index failed to benefit from the surge in two main drivers of its market, crude oil prices and the USD, as soft Q2 earnings and tight domestic financial conditions weighed on returns. The disconnect between oil prices and Saudi Arabian equity performance also reflects the ongoing diversification of the economy, which is the key reason behind our overweight position.

Saudi Arabia has been progressing in enacting structural reforms under the Vision 2030 programme. The country has made considerable headway in reforming the labour market (female labour force participation has already breached its target), improving the regulatory environment and expanding the digital economy. As a result, the country received a glowing review from the IMF in its latest Article IV report, noting that "Saudi Arabia's economic transformation is advancing rapidly".

The success of Vision 2030 is still dependent on the price of crude oil. Indeed, the drop in oil revenues from Saudi Arabia's voluntary output cut and higher public spending has raised the breakeven oil price (estimated at $80-88/bbl). The latest Budget shows expectations for a budget deficit in 2023-25. Saudi Arabia's low public debt stock and current account surplus afford authorities with policy space.

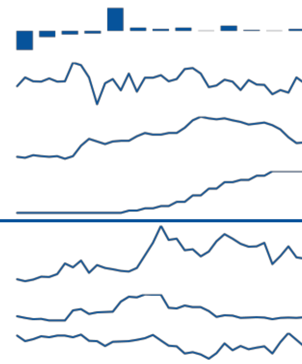
Despite some near-term headwinds from lower oil production, which are likely to lead to a small GDP contraction this year, we are optimistic about the country's direction. The non-oil economy is still very robust, with the PMI above 50 in September, and inflationary pressures are partly contained by the dollar-peg FX regime.

Market Strategy: Saudi Arabia's stock market appears attractive, with the 12m forward P/E premium to EM below its five-year average. With a supportive reform programme underway, Saudi Arabia's stock market will likely continue to attract foreign investors. Thus, we remain *overweight*.

South Africa

Underweight

Reports of power issues being resolved next year are promising, but we are wary that domestic issues will not be quickly resolved.



	3Y history	Latest	
GDP, % yoy		1.6	Q2
PMI, index		49.9	Sep
CPI, % yoy		4.8	Aug
Policy rate, %		8.25	Sep
MSCI South Africa*		-1.7%	Q3
EPS, % yoy		-12.5	Sep
12M Forward P/E		9.5	Sep

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

We continue to see downside risks to South Africa's outlook, given that economic activity is closely tied to the power supply crisis. There are reports that this might ease in H2 2024 as some power units return to service, but the slow pace of improvement so far means that we prefer to wait and see before changing our view. In the meantime, household consumption will be constrained by low confidence, high unemployment and sticky inflation.

In response to energy shortages, a large increase in renewable projects and alternative energy investment has boosted economic activity in Q2. But the import-intensive nature of such investments, along with softer commodity export prices from 2022 highs, have come at the expense of the current account balance. A current account deficit puts downward pressure on the rand.

South Africa's fiscal situation has deteriorated as lower commodity prices and power outages have weighed on government receipts. Moreover, the government's spending bill has increased due to a rise in public sector wages and debt service costs. Combined with the weak growth outlook, the widening fiscal deficit raises concerns over the debt trajectory. With the ruling ANC under pressure ahead of next year's elections, fiscal discipline will be challenging.

Inflation, which has been easing, could start to pick up again due to rising food prices and a weaker rand. As such, the South African Reserve Bank (SARB) will likely keep rates on hold for some time.

Market Strategy: MSCI South Africa's valuations look cheap, with the 12m forward P/E trading at a discount to EM, but we believe the lower multiple is justified. South Africa has one of the weakest economic outlooks within our EM universe. Its twin deficits only adds to the country's risk premium. Therefore, we maintain our *underweight*.

KEY ECONOMIC AND FINANCIAL INDICATORS

	Emerging Market	Macroeconomic Data: % change on year ago: Annual GDP Growth*	Industrial Production*	Consumer Price Index*	Latest 12 months: Trade Balance*	Current Account Balance*	Foreign Reserves 2023 Latest*	Foreign Reserves 2022 Year ago	Currency vs $ 2023 Latest*	Currency vs $ 2022 Year ago	Short-Term Interest Rates*	Sovereign Rating S&P*	Market Data: Performance: % 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	Forecast (Bloomberg)†: 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			%		Sep. 29, 2023	Sep. 29, 2023	%	%		%		
Overweight	INDONESIA	5.2	-1.3	2.3	43.9	9.4	124.2	119.3	15695.0	15315.0	4.0	BBB	2.0	1408.8	4.1	3.4	14.6	28.2	1448	+
	VIETNAM	5.3	5.1	3.7	24.7	19.3	89.2	101.4	24371.0	23878.0	5.4	BB+	0.4	224.8	15.8	19.4	16.8	15.7	237	+
	TAIWAN	1.4	-10.5	2.9	59.8	86.9	564.0	541.1	32.1	31.5	1.5	AA+	14.8	480.9	13.6	19.3	17.5	9.7	490	+
	SAUDI ARABIA	1.2	n.a.	2.0	35.8	15.3	417.9	441.9	3.8	3.8	5.7	A	3.5	162.8	5.8	5.6	18.2	30.8	159	uc
	MALAYSIA	2.9	0.7	2.0	55.9	13.3	103.0	98.9	4.7	4.7	2.7	A-	1.7	346.7	-3.8	2.5	14.7	21.3	363	+
	QATAR	2.7	n.a.	2.4	95.2	63.9	43.0	37.2	3.6	3.7	n.a.	AA	0.8	296.8	-1.5	-1.5	9.7	n.a.	293	uc
Neutral	BAHRAIN	2.0	n.a.	0.0	n.a.	n.a.	4.4	4.3	0.4	0.4	6.4	B+	0.1	319.1	21.4	21.5	n.a.	n.a.	321	uc
	BRAZIL	3.4	0.5	4.6	86.1	-45.3	312.8	310.1	5.1	5.2	8.1	BB-	5.1	727.8	15.0	9.2	8.1	20.5	757	+
	CHILE	-1.1	0.3	5.1	15.9	-13.6	35.5	41.9	919.0	938.2	10.9	A	0.5	387.0	-0.1	4.8	8.8	15.0	424	+
	CHINA	6.3	4.5	0.1	843.0	389.0	3160.1	3054.9	7.3	7.2	1.1	A+	27.0	698.4	-7.5	-6.2	11.0	12.6	723	+
	COLOMBIA	0.3	-3.6	11.0	-13.1	-17.0	53.1	52.2	4320.0	4609.2	12.7	BB+	0.1	4542.2	6.8	-10.3	4.6	31.2	4481	+
	CZECH REP.	-0.6	-1.7	8.5	0.2	-11.4	136.2	136.9	23.3	25.3	6.8	AA-	0.1	1486.7	26.1	28.2	11.7	n.a.	1589	+
	EGYPT	6.7	-10.1	37.4	-32.1	-8.2	24.2	23.7	30.9	19.7	19.3	B	0.1	1496.8	15.9	44.7	7.3	n.a.	58	-
	GREECE	2.7	-1.9	2.7	-37.3	-17.9	4.2	3.0	1.1	1.0	0.0	BB+	0.4	48.6	31.5	32.5	4.8	10.1	615	+
	HUNGARY	-2.4	-6.1	16.4	2.6	-9.2	34.3	28.4	369.2	440.3	11.2	BBB-	0.2	587.7	30.9	28.0	5.0	n.a.	623	+
	KUWAIT	8.2	n.a.	3.8	n.a.	63.2	42.6	40.7	0.3	0.3	3.4	A+	0.8	133.5	-6.2	-5.3	15.3	n.a.	126	
	MEXICO	3.6	4.8	4.6	-10.7	-72.5	183.3	179.7	18.3	20.0	11.5	BBB	2.2	604.3	20.6	7.8	11.9	16.4	658	+
	MOROCCO	2.3	1.9	5.0	-16.8	-3.1	31.8	28.6	10.3	11.0	2.4	BB+	0.2	619.5	15.3	13.3	13.4	23.1	621	
	NIGERIA	2.5	n.a.	25.8	4.5	5.1	28.7	32.9	771.1	435.5	9.0	B-	0.1	159.0	-9.7	56.4	6.9	n.a.	340	+
	PERU	-0.5	-1.3	5.0	14.1	-4.9	68.7	71.9	3.8	4.0	0.2	BBB	0.2	1917.8	8.7	8.5	10.6	n.a.	2020	+
	POLAND	-0.6	-2.0	8.2	-3.3	0.0	155.4	135.3	4.4	5.0	6.8	A-	0.7	305.0	13.8	13.2	7.1	13.6	318	+
	ROMANIA	1.1	-5.3	9.4	-32.4	-23.6	55.0	39.2	4.7	5.1	6.3	BBB-	0.1	219.8	27.9	29.6	8.1	44.2	237	+
	SOUTH KOREA	0.9	-0.5	3.7	-38.7	9.3	393.9	412.8	1354.6	1429.7	3.8	AA	11.7	536.0	8.0	15.1	17.0	6.8	184	+
	UAE	7.4	n.a.	2.3	79.0	48.0	158.0	115.9	3.7	3.7	5.5	NR	1.5	183.1	7.4	7.4	9.8	n.a.	182	uc
Underweight	INDIA	7.8	5.7	6.8	-257.5	-58.2	537.2	511.5	83.2	82.4	6.0	BBB-	17.6	1790.0	12.5	12.9	23.0	14.0	1883	+
	SOUTH AFRICA	1.6	2.3	4.8	3.6	-22.0	47.4	46.2	19.4	18.1	9.0	BB-	2.6	666.6	-10.2	-0.6	11.6	21.3	661	+
	THAILAND	1.8	-7.5	0.3	12.6	0.0	203.6	221.8	37.1	38.0	2.5	BBB+	1.8	1136.4	-14.7	-10.4	18.0	9.4	1177	+
	PHILIPPINES	4.3	8.5	6.1	-54.6	-13.6	85.1	86.6	57.1	59.0	6.3	BBB+	0.7	691.7	-3.1	-1.6	12.6	22.3	723	+
	TURKEY	3.8	7.5	61.5	-118.3	-58.5	57.4	49.5	27.7	18.6	51.7	B	1.1	499.1	6.9	56.3	6.3	13.8	533	-
	ARGENTINA	-4.9	-13.3	124.4	-1.5	-13.5	21.0	29.1	350.1	149.2	113.7	CCC-	0.8	1147.1	44.7	185.9	6.9	21.1	1155	-

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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