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Focus on emerging markets' long-term winners

Vietnam and India look to have taken advantage of China's meltdown

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As an adventurous type I've long championed emerging and frontier markets. But it hasn't been an especially successful strategy in recent years, as US equities in particular have come to dominate.

So it is with some trepidation that I suggest it might be worth revisiting this approach in the coming year — with some important modifications. Let us first remind ourselves that although the US represents only a quarter (24 per cent) of world GDP in cash terms, its stock markets account for 62 per cent of global equity market capitalisation.

Contrast that with a statistic noted by Charlie Robertson, chief economist at emerging markets-focused investment bank Renaissance Capital. He says roughly 340mn Africans and 355mn South Asians will enter the 15-19 age group in the 2020s. Basic economic theory suggests that countries benefiting from a demographic surge in the younger generation tend to be long-term economic winners, says Robertson, author of *The Time-Travelling Economist*, a new book on developing economies.

Against this, emerging market (EM) assets — equities and debt — face savage headwinds over the next few months, not least from a strong dollar, which is causing havoc everywhere, including in the UK (sterling is now regarded by some as an emerging markets currency).

But even if this dire economic scenario, which is likely to presage a slowdown or recession, wasn't bad enough, the EM space also faces a deep structural problem. The main indices used for tracking this space such as those offered by MSCI are no longer fit for purpose.

Investing in a broad global EM equity class is increasingly pointless, and investors should adopt a rifle shot approach to individual countries. China and its closely dependent trading partners Hong Kong, Taiwan and South Korea now comprise a massive chunk — around 65 per cent of the total index value — with another chunk belonging to wealthy countries such as the United Arab Emirates and Kuwait. Developing? Maybe, but hardly emerging.

The rifle shot approach to picking out countries and markets with high potential but perhaps low valuations is, I would suggest, a more sensible approach. These include India, Vietnam, and even Turkey, where president Recep Tayyip Erdoğan's effective one-man rule faces an electoral test next year.

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Latin America is also interesting if we somehow avoid a recession and I'd now go for India any day over China. Its stocks are expensive but, as Robertson reminds us, buying high-growth countries — with high multiples — might not make sense over a one-year timeframe but does pay off over 10 years.

"If you can identify the countries that might grow at 7 per cent a year, doubling the economy in a decade, quadrupling it over a generation and growing eight times over 30 years, then investors should do much better than those investing in countries growing at just 2 per cent a year," he says.

Vietnam is another winner from the China meltdown. I was struck by this recent comment from Dynam Capital, manager of one of the biggest London-listed Vietnamese funds. "Vietnam is fast becoming one of the main beneficiaries of shifting supply chains and in recent months has increasingly shown how the government's 'open for business' policies are paying off." Pham Minh Chinh, Vietnam's prime minister, rang the closing bell of the New York Stock Exchange (NYSE) in May. Somehow I can't imagine any Chinese state official being hosted at the NYSE

Robertson makes two observations worth repeating. The first is that electrification will be needed for manufacturing in developing countries (preferably of the cheap, renewable kind). I'd highlight a newish renewables fund called Thomas Lloyd Energy Impact which trades at a 7.3 per cent premium on 89.5p. It is steadily rolling out a portfolio of valuable renewable assets in India and Philippines, two countries at the top of most investors' lists.

And then there's Africa, which has been something of a graveyard for the hopes of many UK investors. I still think this is the continent to watch, but I'm also acutely aware that too many listed African investments have come unstuck. But there are two I would suggest keeping an eye on, both listed in London.

Helios Towers owns an array of mobile phone masts across the continent and is benefiting from the boom in mobile broadband coverage. Its shares have been hammered in recent months but they are now looking more interesting.

I am also running the slide rule over Grit Real Estate Income Group, which owns a property portfolio of long-term leases with high-quality, multinational tenants with a big focus on the three Ms: Mozambique, Mauritius and Morocco. I think there's a decent chance that discount will tighten over the next few years as investors realise that the portfolio looks fairly robust.

As with Helios, the shares have had a terrible time and are down 25 per cent over the past year. They now trade at a cavernous discount to NAV — the share price is 36p but NAV is currently at $0.87ps, and yields 5.3 per cent with occupancy running at 94 per cent.

For specific countries in Africa, I would echo Robertson and look out for Morocco, Ghana, Kenya and Rwanda. I believe these will be the ones for investors to watch over the next 10 to 20 years.

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