# CHINA & EMERGING MARKETS OUTLOOK

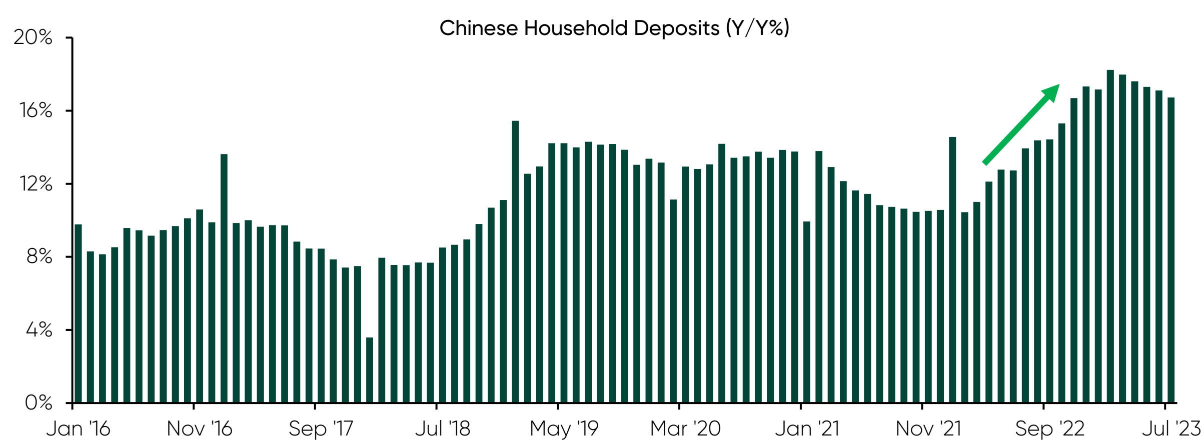
## NOVEMBER 2023

## LATEST VIEWS ON THE CHINESE ECONOMY

In our view, China's economy should continue its gradual return towards pre-pandemic trends and avoid a widely feared economic hard landing. While notable headwinds exist from the property sector and US-Sino tensions, we expect these to be largely offset by well-capitalised consumers, increased government policy support, and a recovery in the global manufacturing system. Ultimately, the country should keep modestly contributing to global growth—helping global and emerging market equities in the process.

Many sectors of China's economy are showing renewed signs of life and the Chinese consumer is much healthier than most appreciate. (Exhibit 1) Household deposit growth is near 10Y highs, non-housing related retail sales & travel growth indicate recovery, and service PMIs show healthy expansion. Recent economic data illustrates the economy's continued grind forward. GDP growth eased from 6.3% y/y in Q2 to 4.9% in Q3, but kept in line with the government's long-running target of "around 5%." Industrial production rose 4.5% y/y in September, matching August's rate, while retail sales accelerated from 4.6% to 5.5% and manufacturing PMIs tipped back into expansion. These figures are perhaps unimpressive if your reference point is China's double-digit growth rates in the 2000s and early 2010s but those times are long gone, and current rates are mostly in line with the gradual deceleration since then. In large part, that stems not from China perpetually weakening, but from the economy growing from an increasingly larger base—a typical feature as a country matures. It looks to us like, after more than three years of lockdown-related dislocations, China's economic indicators are slowly reverting to longer-term trends.

Exhibit 1: Chinese Households Strengthened During Lockdowns




*Source: FactSet. Banking & Credit, Depository Financial Institutions, Domestic Deposits, Households, in RMB & Foreign Currency, monthly, 01/01/2016 – 30/09/2023.*

However, despite positives in many parts of the economy, China's property market remains a headwind. The current property downturn is the deepest in China's history with property sales down -25% y/y and real estate investment down -8.8% y/y in the first three quarters of 2023. Developer funding issues continue to drive fears of widespread defaults and uncompleted projects are weighing on household confidence. Most recently, developer Country Garden has been in the headlines for its inability to pay its debts. However, the government appears committed to stabilising sentiment and ensuring macroeconomic stability. It has promised to complete unfinished projects, introduced top-down regulatory loosening, and lowered mortgage rates and taxes. It also introduced initiatives to spur purchases of distressed assets by state-owned enterprises to encourage minimally disruptive restructuring.

We don't dismiss property market headwinds, but—crucially for markets—they aren't new. More than two years have passed since property developer Evergrande started missing bond payments, and the government has been slow-motion unwinding it ever since. All this is very well-known to markets and economic forecasters. It has been the focal point of financial coverage of China since early 2022, if not sooner. If China's output has demonstrated it can grow through two years of property woes, we doubt it becomes an insurmountable headwind now, especially with the government and central bank continuing to backstop the sector. Pundits might quibble with the specifics and whether every program in place passes a detailed cost-benefit analysis, but markets don't need policy perfection in China or anywhere else.

When it comes to China's impact on broader equity markets, the question is simple: Is sentiment toward its global economic contributions too optimistic, too dour or just right? Today, it remains far from optimistic, though it isn't as deeply pessimistic as a few months ago. It seems more skeptical than anything—acknowledging that things weren't as bad as initially feared but still focusing on headwinds. In our opinion, that seems sufficiently bullish.

## CHINA EQUITY PERFORMANCE EXPECTATIONS

The universe of Chinese equities is currently 993 constituents and includes companies across all sectors, sizes and styles. Fisher Investments does not form a homogenous view on Chinese equities, and seeks to take advantage of the spreads between categories of Chinese equities, expressing our top-down views via sub-asset allocation decisions. A number of headwinds weighed on growth more than expected last year, but the government has responded with policy support, including removing zero-COVID policies, interest and reserve rate requirement cuts, tax cuts and other measures to support businesses. Economic stability is the government's top priority this year as the country exits lockdowns. However, while monetary and fiscal policy should remain accommodative, they likely fall short of past stimulus initiatives. Overall, a healthy Chinese consumer is likely partially offset by continued Real Estate weakness and soft external demand. Tied to these views, and the reversal of previous regulatory headwinds, we continue to favour the consumer and service portions of the Chinese market, relative to the state-owned heavy industry and financial sectors.

## US-CHINA RELATIONSHIP

Chinese relations with the US and the western world are at generational lows. The spectrum of disputes vary widely, ranging from the legal status of Hong Kong and Taiwan, US concerns around technology and intellectual property, and accounting oversight of US listings. While there have been some recent signs of tensions thawing, China remains a popular and easy target for US and Western political angst—particularly as we get closer to the 2024 US presidential election. Additionally, western sanctions on the Chinese semiconductor industry likely hamper technological development.

Global competition between the US and China continues to have downstream impacts on the Information Technology sector. We expect increased trade barriers and export restrictions to lead to the diversification of supply chains in semiconductors and other strategic industries over time. This may increase protectionist spending that favors domestic suppliers at the expense of multinational tech firms and dependent supply chain exposed tech firms.

In restricting exports, the US is attempting to stifle Chinese advancement within semiconductors, most recently with the Chips Alliance with Japan and the Netherlands. The goal is to decrease reliance on China, strengthen relationships with US allies and gain more market share from Chinese manufacturers.

However, despite fears of increased US-China tensions, trade between the two countries remain strong. Both US exports to China and imports from China have stayed at steady levels. (Exhibit 2)

Exhibit 2: US Trade with China


*Source: FactSet in billions of USD. Based on trailing 12 month moving average data. Data shown from 01/01/1993 to 30/09/2023.*

## CHINA'S IMPACT ON OTHER MAJOR EM COUNTRIES

### TAIWAN

With nearly 75% of its economy based on exports, Taiwan is highly dependent on global trade, particularly for high-end semiconductors. Furthermore, Taiwan is somewhat caught in the fray as the US moves to limit exports of advanced semiconductors to mainland China. However, Taiwan Semiconductor received an exception from the recent China export ban for a second year, and management expects the long-term impact to be limited and manageable.

Politically, Beijing views Taiwan as part of its territory and leaders have vowed to eventually "unify" the island with the mainland. This has sparked concerns of a conflict that could expand into a larger war involving Western powers. Current tensions remain high as China has increased military activity in the area, but the probability of full-scale war in the wake of Russia's invasion of Ukraine remains low, in our opinion, especially given the difficulties China faces domestically with slowing growth, rising youth unemployment and a troubled property sector.

## SOUTH KOREA

From South Korea's perspective, tensions with North Korea, a China ally, remain an ongoing concern. Separately, the Biden Administration introduced export curbs on China's access to US semiconductor technology, raising fears the industry's inventory correction cycle will be elongated.

However, South Korea's equity market is favorably weighted towards cyclical, economically sensitive industries we expect to outperform in a new bull. Moreover, it stands to benefit from a less aggressive Fed and falling inflation as well as China's return to pre-pandemic slow growth trends. Political stability following a string of scandals boosted sentiment, though President Yoon Suk-Yeol's party lacks enough votes in the National Assembly to pass substantive legislation despite an agenda centered around pro-growth initiatives and deregulation.

Furthermore, South Korea's Technology sector accounts for a quarter of the Information Technology sector in the MSCI Emerging Markets Index. The sector is heavily weighted to economically-sensitive, cyclical industries—such as semiconductors—a characteristic desirable at this stage of the cycle. The semiconductor industry has faced a prolonged downturn, but fundamentals appear to have bottomed in 2H23. Semiconductor equities tend to move in advance of a bottom in fundamentals by roughly two quarters, suggesting they are well-positioned to benefit from a new bull market.

## INDONESIA

In Indonesia, strong investment and consumption trends put the country among the fastest growing economies in the world. As investors search for growth with China structurally slowing, Indonesia should be a prime beneficiary.

Indonesia's market also tilts toward value-oriented sectors, and select opportunities remain within the underdeveloped and underpenetrated banking sector. This leaves the household, corporate and public sectors in a healthy position to utilise credit and expand capacity. Portfolio positioning tilts towards high-quality banks leveraged to favorable areas, such as micro-finance and business lending. Credit growth is in the double-digits and among the highest in Emerging Markets.

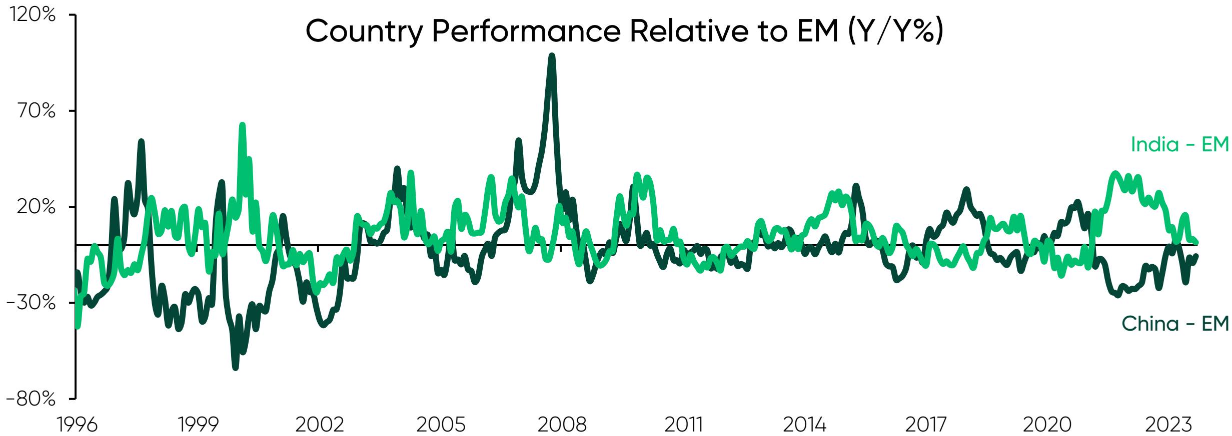
Rising infrastructure spending, expanded free trade and increased political stability under President Widodo also provide a positive macro backdrop.

## INDIA

India is a prime beneficiary of increased tensions between China and the US. India has a deep-rooted, post-colonial tradition of non-alignment, preferring partnerships over alliances. This allows India to play both sides to its own benefit. The war in Ukraine is a pertinent example—India benefits from Russian crude oil purchases without running afoul of the US government because of its strategic importance in countering China in the Indo-Pacific.

Chinese and Indian equities usually move independently of one another. Since 1996, the correlation of the year-over-year relative performance of China and India has been close to zero. Recently, a very strong inverse relationship has developed and money rapidly leaving China has flowed to India. However, we believe this strong short-term, inverse relationship will eventually prove fleeting. (Exhibit 3) This is to say that we cannot extrapolate this trend moving forward, but rather that recent fear in China has seemingly positively driven Indian equities.

Exhibit 3: India Has Recently Moved Inversely to China




*Source: FactSet, USD, based on MSCI EM, MSCI China and MSCI India, monthly total return, 31/12/1995 – 30/09/2023.*

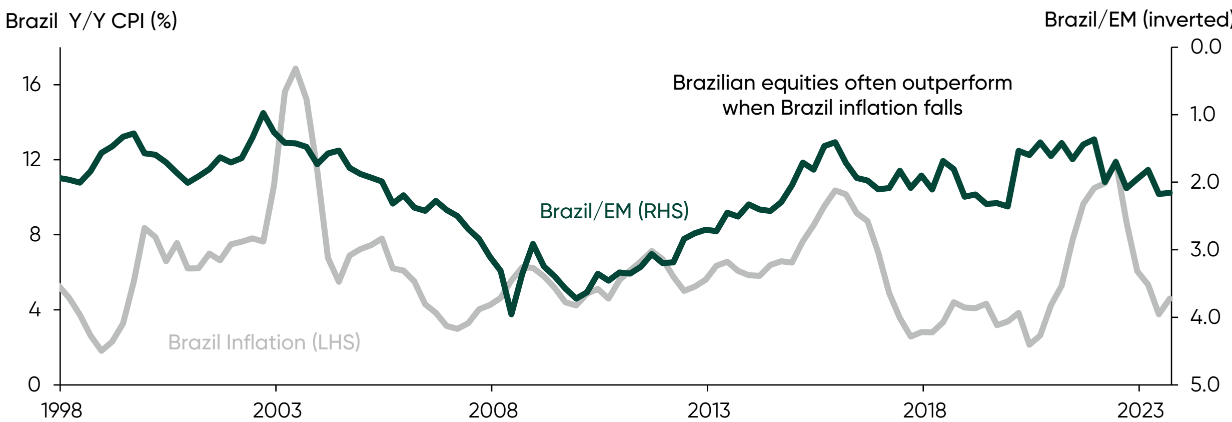
We are underweight India as optimism for the country's strong economic growth has pushed expectations near decade highs relative to broader emerging markets. Expectations remain elevated despite high oil prices and recent inflation concerns, which are typically headwinds for Indian relative performance. India has also benefitted from a rotation away from Chinese growth positioning. Sentiment on Chinese shares remains overly negative, in our view, suggesting the possibility of a reversal of recent trends. Campaigning for 2024 elections has also begun, and Prime Minister Modi remains the front-runner, though there is little pro-market reform on his agenda.

## BRAZIL

In Brazil, anticipation for China's re-opening this year drove optimism for Brazilian equities, which typically benefit from Chinese economic growth.

Elevated commodity prices, domestic deflation and improving Chinese demand should help Brazil's economic activity exceed overly dour expectations. (Exhibit 4) Political fears are high as investors speculate on Lula's policy and legislative goals, but sentiment likely improves as political gridlock reduces legislative uncertainty.

Exhibit 4: Inflation in Brazil is Moderating



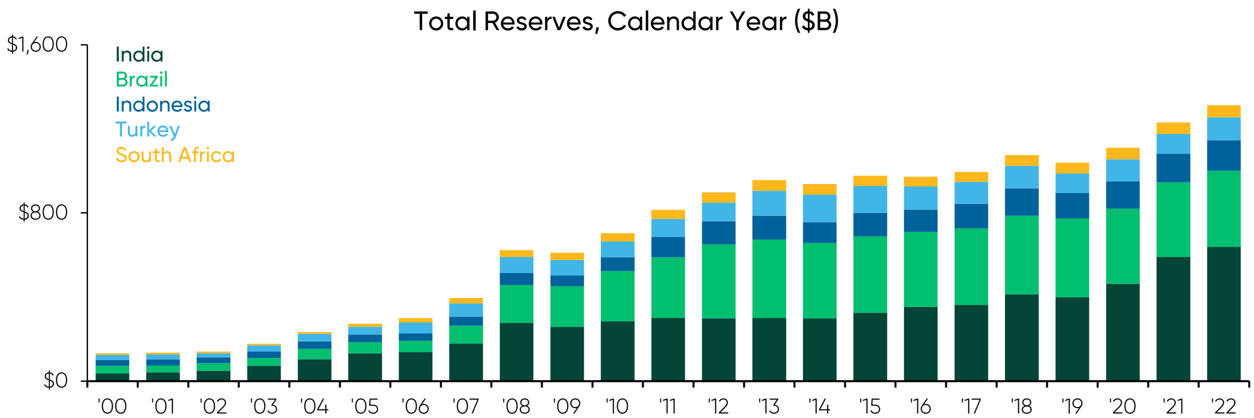

*Source: FactSet, USD, based on relative gross returns of MSCI Brazil and MSCI EM & Brazil Consumer Price Index (CPI), quarterly, 01/01/1998 – 30/09/2023.*

## DO HIGHER US RATES HURT EM?

A US Federal Reserve fed-funds rate hike does not inevitably spell trouble for Emerging Markets (EM) equities as performance after US rate hikes is mixed, implying no established relationship. The so-called "Fragile Five" emerging markets suffered during prior QE tapering but are mostly in fundamentally better positions today. (Exhibit 5) While some may argue rate hikes trigger EM crises—Mexico in 1994, the Asian Financial Crisis in 1997, the Russian Ruble Crisis in 1998 or Brazil in 1999—and fear one could be around the corner, severe fundamental economic weakness already persisted in each of these situations. EM rate hike fears stem from a false assumption: EM stability and growth are linked to low US interest rates and that rising or high US interest rates trigger EM capital flight and the occasional crisis. This seems to be grounded in an oversimplification of history.

While EM crises over the past 20 years happen to coincide with Fed tightening, higher US interest rates alone did not necessarily cause them. Furthermore, as equity markets are efficient discounters of all widely known information, much-discussed fed-funds rate hikes lack the surprise power to derail EM equities.

Exhibit 5: Fragile Five Less Vulnerable




*Source: World Bank. Shows aggregated total reserves and current account base for India, Brazil, Indonesia, Turkey and South Africa. Bases on annual data from 2000-2022, the latest available data.*

## DOES A STRONGER DOLLAR HURT EM?

The weakness we have recently seen in EM currency is less about weakening fundamentals in EM and more about US dollar (USD) strength, in our view. A flight to safety as a response to 2022's bear market likely explains some of what we saw, where heightened risk aversion drove flows from traditionally "weak" hands (e.g. EM currency) to "safer" hands (e.g. USD). Furthermore, investors are particularly wary of a strengthening dollar's impact on USD-pegged countries. EM countries overall have evolved considerably since the 1990s. Their foreign currency reserves are much larger and their growth does not depend wholly on foreign investment. Moreover, their capital markets are more mature with few fixed exchange rate regimes remaining after the late-1990s Asian Currency Crisis. However, we do want to state that since the inception the United States Dollar Index in the mid-1990's, we have noticed an inverse relationship with EM returns. (Exhibit 6) Furthermore, while EM relative returns are positive 89% of the time during periods of weak USD, only three sectors outperform more than 50% of the time during these periods (Materials, Energy, Consumer Discretionary).

Exhibit 6: Relationship of DXY and MSCI World/MSCI EM


*Source: FactSet. MSCI World/MSCI Emerging Markets Daily Total Return and DXY Daily Index Level. 31/12/1994 to 04/10/2023. USD.*

## POSITIVE DRIVERS FOR EM

### EMERGING MARKETS COMMENTARY

Emerging Markets (EM) remains attractive on a selective basis. Despite a reputation as value-dominated, EM is no longer a homogeneous category. Many of the world's largest and highest quality growth firms are located in EM, and its largest sector by weight is Information Technology—desirable attributes moving forward given underperformance in last year's bear market. While China faces numerous headwinds, they are widely discussed and well-known, suggesting the possibility of upside surprise given pervasively negative sentiment.

Many Emerging Market countries are likely to re-prioritise pro-growth-oriented reform following COVID and inflation-led disruptions the past few years. Previously, market-friendly reforms included lowering taxes, liberalising financial markets and opening state-run industries to private competition. These measures should help drive future economic growth through more efficient allocation of resources.

Furthermore, globalisation and the expansion of free-trade agreements continue to allow EM countries to better capitalise on comparative advantages and specialisation of labor. Recent geopolitical tensions between China and the West have led to export restrictions in key industries, leading China to push to create its own homegrown versions. While this creates near-term trade uncertainty, the West remains China's most significant market for goods. Moreover, production is being reallocated to other Emerging Markets.

While individual nations do face headwinds, sentiment towards Emerging Markets nations remains excessively pessimistic relative to economic and political fundamentals, in our view. This should set up positive surprise looking forward, fuelling rising markets.

# DISCLOSURES

*Fisher Investments Ireland Limited trades as Fisher Investments Europe (FIE) and is regulated by the Central Bank of Ireland. Fisher Investments Ireland Limited and its trading name Fisher Investments Europe are registered with the Companies Registration Office in Ireland under numbers 623847 and 629724. Fisher Investments (FI) is an investment adviser registered with the United States Securities and Exchange Commission. FIE is wholly-owned by Fisher Asset Management, LLC, trading as Fisher Investments (FI), which is wholly-owned by Fisher Investments, Inc.*

*Fisher Investments (FI) is an investment adviser registered with the Securities and Exchange Commission. As of 30 September 2023, FI managed $205 billion, including assets sub-managed for its wholly-owned subsidiaries. FI and its subsidiaries maintain four principal business units – Fisher Investments Institutional Group (FIIG), Fisher Investments Private Client Group (FIPCG), Fisher Investments International (FII), and Fisher Investments 401(k) Solutions Group (401(k) Solutions). These groups serve a global client base of diverse investors including corporations, public and multi-employer pension funds, foundations and endowments, insurance companies, healthcare organisations, governments and high-net-worth individuals. FI's Investment Policy Committee (IPC) is responsible for investment decisions for all investment strategies.*

*For purposes of defining "years with Fisher Investments," FI was established as a sole proprietorship in 1979, incorporated in 1986, registered with the US SEC in 1987, replacing the prior registration of the sole proprietorship, and succeeded its investment adviser registration to a limited liability company in 2005. "Years with Fisher Investments" is calculated using the date on which FI was established as a sole proprietorship through 30 June 2023.*

*FI is wholly owned by Fisher Investments, Inc. Since Inception, Fisher Investments, Inc. has been 100% Fisher-family and employee owned, currently Fisher Investments Inc. beneficially owns 100% of Fisher investments (FI), as listed in Schedule A to FI's form ADV Part 1. Ken and Sherrilyn Fisher, as co-trustees of their family trust, beneficially own more than 75% of Fisher Investments, Inc., as noted in Schedule B to FI's Form ADV Part 1.*

*FIE outsources portfolio management to FI. FI's Investment Policy Committee (IPC) is responsible for all strategic investment decisions. The Joint Investment Oversight Committee (IOC) is responsible for overseeing FI's management of portfolios that have been outsourced to FI.*

*This document has been approved and is being communicated by Fisher Investments Ireland Limited.*

*The foregoing information constitutes the general views of Fisher Investments and should not be regarded as personalised investment advice or a reflection of the performance of Fisher Investments or its clients. Investing in financial markets involves the risk of loss and there is no guarantee that all or any capital invested will be repaid. Past performance is never a guarantee nor reliable indicator of future results. Other methods may produce different results, and the results for individual portfolios or different periods may vary depending on market conditions and the composition of a portfolio or index. The value of investments and the income from them will fluctuate with world financial markets and international currency exchange rates. If you have asked us to comment on a particular security then the information should not be considered a recommendation to purchase or sell the security for you or anyone else. We provide our general comments to you based on* *information we believe to be reliable. There can be no assurances that we will continue to hold this view; and we may change our views at any time based on new information, analysis or reconsideration. Some of the information we have produced for you may have been obtained from a third party source that is not affiliated with Fisher Investments. Fisher Investments requests that this information be used for your confidential and personal use.*