



September 2023

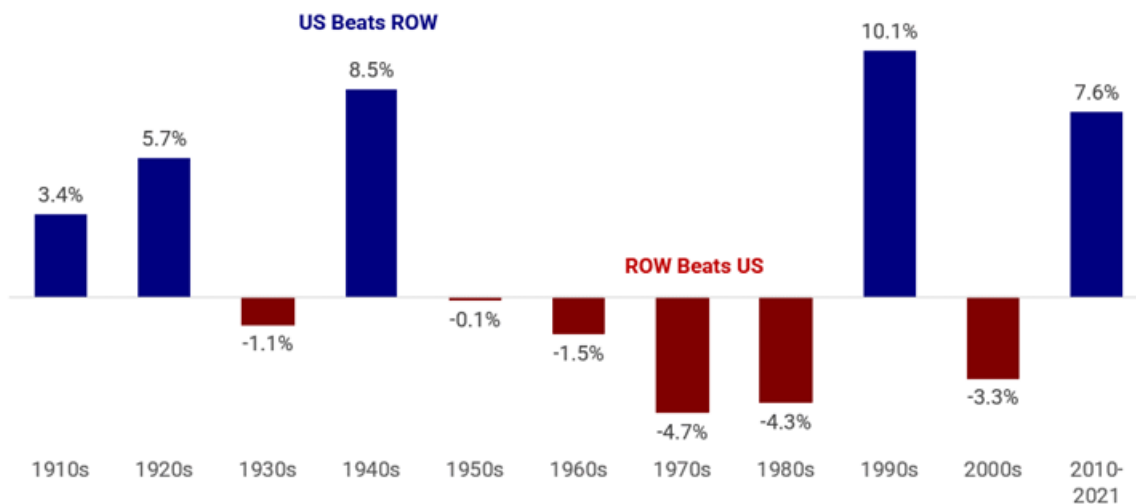
## Why Emerging Markets Now

Only a year ago the story prevailing in global markets was black and white. The US was headed for recession, with no way out, and China was heading for a reopening boom. Neither happened, and now the consensus has changed its mind, completely. China is the new Japan, doomed to stagnation, and America is the resilient miracle economy, with ominous implications for emerging markets. Weak Chinese growth will spillover to other emerging markets, a resurgent dollar will undermine EM returns, and so on. Rather than wait for the consensus to flip flop again, we'd point out that the fundamental case for EM doesn't change with these mood shifts.

### The Decadal Cycles

The global markets don't move in straight lines, they move in cycles, with new winners arising in each decade. After a lost decade for international investing in the 2010s, the likelihood is that emerging markets will find their stride again in the 2020s.

Chart 1. Average Annual Stock Market Returns by Decade, US v Rest of World in Real USD Terms (Percent)



Source: Credit Suisse, DMS Database 2022, Copyright © 2022 Elroy Dimson, Paul Marsh and Mike Staunton Note; ROW = Rest of World

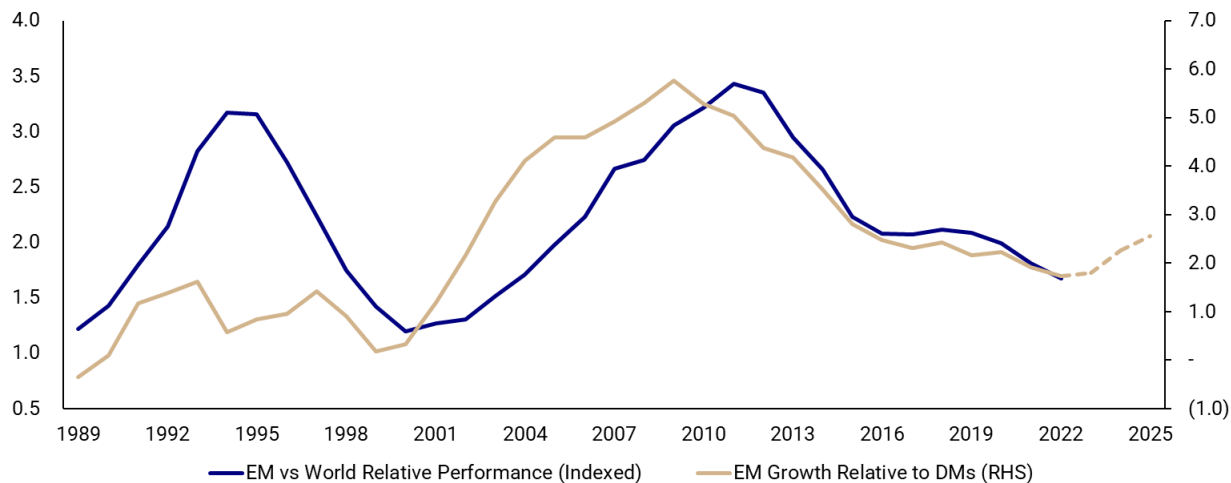
### Returns Follow Growth

Historically EMs have outperformed when their GDP growth lead over developed markets was widening. Despite the gloom around China, that gap is expected to widen in coming years.

# Breakout Briefings

## Our Worldview in Charts

Chart 2. Relative Performance of EM Equities (in blue), and EM Growth Relative to DMs (in yellow) (Indexed; Percentage Points; Dotted line Shows IMF forecasts)

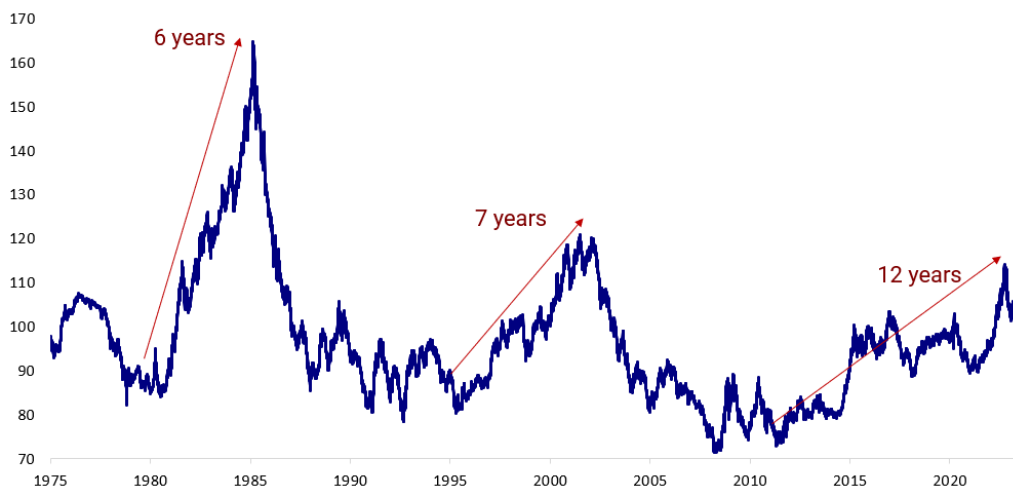


Source: Bloomberg, IMF forecasts, Breakout Capital Calculations

### The Cracks in the Dollar

The US is running steep deficits alongside a tight monetary policy, which is a classic recipe for a spurt of growth and dollar appreciation, as we are seeing now. It's also a recipe for longer term decline, which is already overdue. The normal upswing in the dollar cycle runs 6 or 7 years, while the current upswing is 12 years old.

Chart 3. Dollar Index (Red arrows Show the Upcycle Duration)



Source: Bloomberg. Note; The chart shows the DXY Index

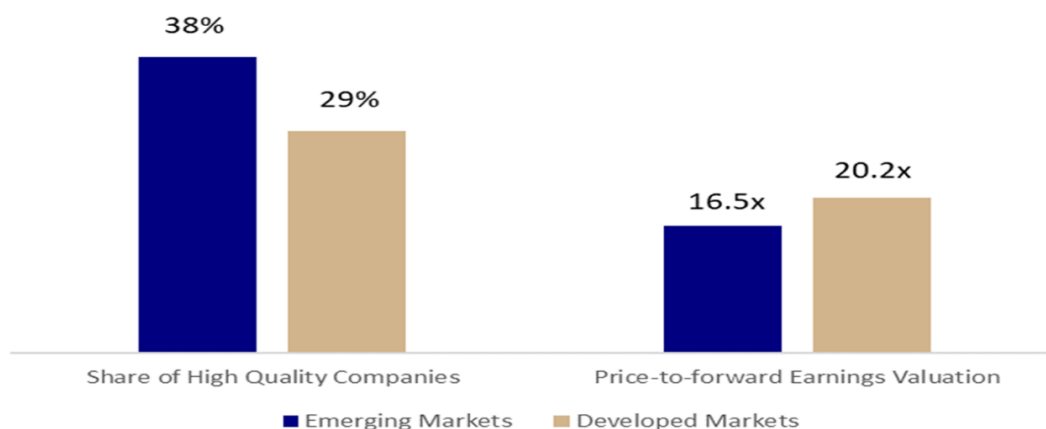
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### Quality Companies

There are plenty of high quality companies in emerging markets. And EM has a higher share of companies that fit these criteria than DM does.

Chart 4. Share of High Quality Companies and Valuations  
(Percent of GDP)

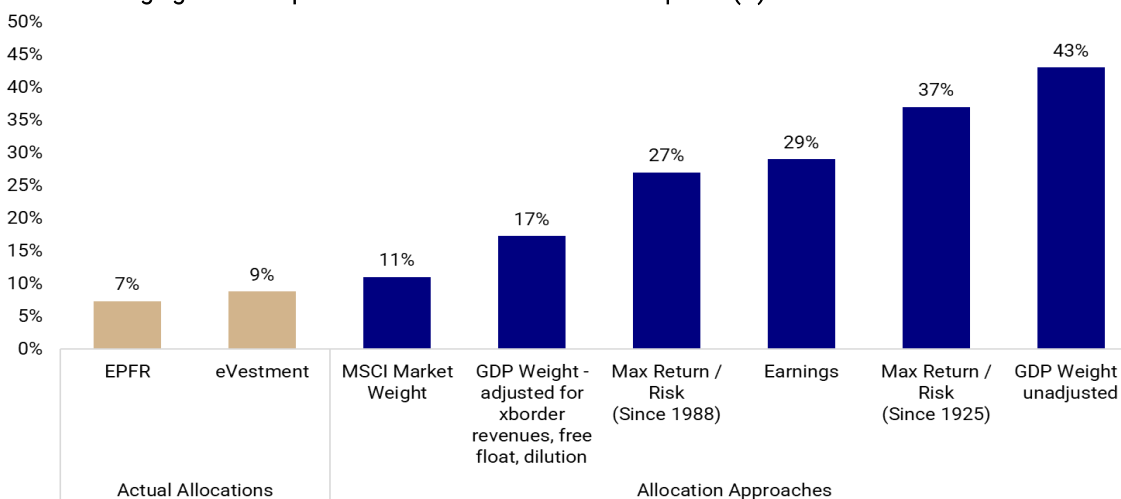


Source: Factset, Breakout Capital Calculations. As of September 1, 2023. Companies with market cap larger than 5 billion. High ROE is defined as greater than 15%. Low leverage is defined as having net debt less than 2x EBITDA. Excludes Financials.

### Underweight EM by Any Measure

Using standard approaches, based on the size of their economies or markets or earnings or efficient risk allocation methodologies, investors would allocate somewhere between 11 and 42 percent of their portfolios to emerging markets. That is far higher than their actual allocations today.

Chart 5. Emerging Market: Optimal vs Actual Allocation to EM Equities (%)



Source: Bloomberg, EPFR (Emerging Portfolio Fund Research), eVestment, Factset, IMF, Global Financial Database, Morgan Stanley, Breakout Capital Calculations. Note: Max Return/Risk (since 1998), and Max Return/Risk (since 1925)

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For more information,  
please contact:

**Cheryl Galante, Head of Investor Relations**  
Main 212 497 5100 | Direct 646 216 8400  
[cgalante@breakout-capital.com](mailto:cgalante@breakout-capital.com)