BREAKOUT CAPITAL
in strategic partnership with Rockefeller Capital Management

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Breakout Capital Quarterly Q2 2024

Outlook

There are two broad themes that have stood out for emerging market returns this year:

1. **Artificial-Intelligence:** The AI-inspired rally spread to emerging markets this year. The five top stocks in MSCI EM account for around 80% percent of total returns, their highest share in five years, and most are tied to AI (Hon Hai, SK Hynix, TSMC, Meituan, and Tencent). This echoes the story in the United States where, year to date, the AI giant Nvidia is up 165% and accounts for almost 50 percent of S&P 500 returns.

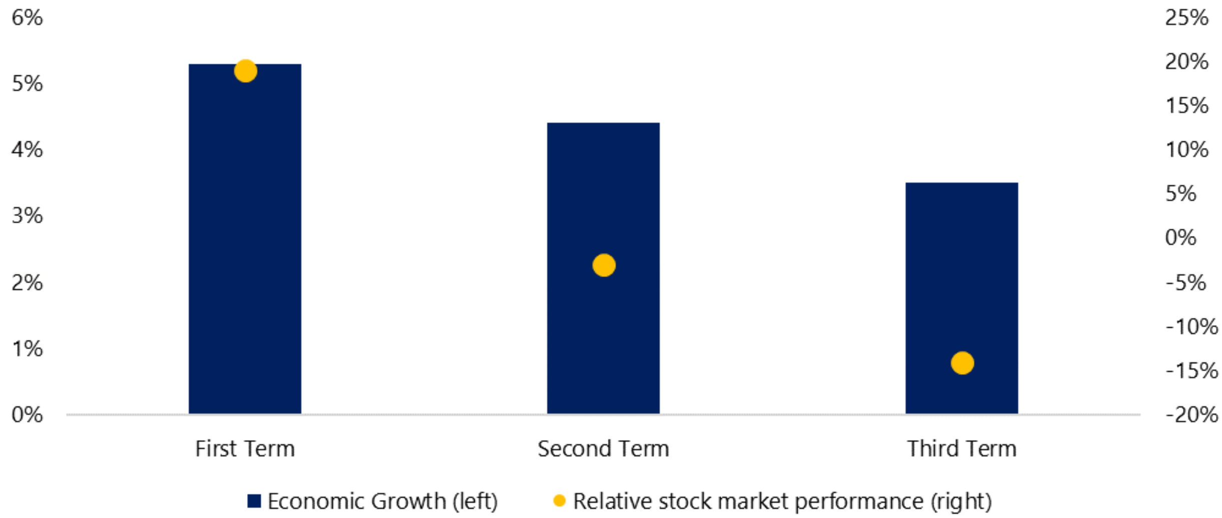
   We continue to believe that this momentum will slow as investors return to focusing on the monetization potential of AI, and the high capital expenditure that will likely weigh on the free cash flows of the market winners today—mainly semiconductor-related companies. Money flowing into AI has left many other, high-quality EM companies trading at inexpensive valuations; based on trends over the last 8 decades, we expect some of these overlooked stocks to emerge as winners in coming years.

2. **Elections:** This is a historic year with more than 30 elections, and nearly 50 percent of the global democratic population going to the polls. With investors wondering how newly elected leaders impact economic and market performance, we looked at some of the key questions: does it matter if a leader was the challenger or the incumbent? Is right or left-wing? Leads a strong majority or a weaker coalition government? We found that only the first question really seems to matter: new leaders are strongly associated with higher growth and returns, but their ideology and parliamentary backing have little impact.

   Studying 50 large democracies since 1980, we discovered 70 new leaders who lasted beyond one term. We found economic growth declines the longer a leader stays in office, especially in emerging countries, where institutional constraints are fewer and leaders can have a more meaningful impact on economic outcomes. In emerging markets, growth

   averaged 5.3 percent in a leader's first term, 4.4 percent in the second and just 3.5 percent in the third. Similarly, the stock market typically outperformed peers by 20 percent in a leader's first term, generated middling returns in the second term, and significantly underperformed during the third.

Economic and Financial Market Impact by Leadership Term
(Percent)



Source: Haver, National Sources, Breakout Capital Calculations

When left-leaning candidates win, investors often take flight—but not necessarily for long. What matters more than ideology is the policies leaders adopt in office: a classic example is Brazil in 2002; Luiz Inacio Lula da Silva had sounded like a radical on the campaign trail, investors fled when he won, but returned when he turned economically orthodox once in office. The basic pattern—of a non-ideological market response to political leaders—is well established: one study covering 24 OECD countries over 173 elections since 1980 showed no statistically significant differences in returns under left-wing and right-wing executives.

History also shows that like left wing leaders, fractured parliaments are not necessarily bad economic news either. In countries such as India, Brazil and Italy, the economy has done better under minority governments. Coalition politics can check the power of developing world leaders and prevent them from pursuing extreme economic policies. India, for example, adopted a less socialist approach to policymaking only after it became a true multi-party democracy in the late 1970s, and the economy started to shrug off stagnant per capita income growth in the following decades.

Of course, politics is only one of many factors that shape emerging markets, and leaders are only one of many political factors. But this is a start, and the takeaway is clear: for investors trying to get a grip on the likely impact of 2024 elections, it is better to start with how new the winners are, not where they stand on the political spectrum or how strong their majority is.

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