



Secular Trends Driving Emerging Markets Growth

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The landscape for emerging markets is changing. How are these markets evolving? What are the key secular growth trends? And which markets should investors focus on? In this discussion with Institutional Investor's Mike Corcoran, William Blair's Todd McClone provides his take.

Watch the video or read the recap below.

Mike: Hi everybody. Thanks for joining us. I'm Mike Corcoran. We're with Todd McClone, a portfolio manager for William Blair's emerging markets strategies.

We're here to talk a little bit here today about what's driving secular trends and driving growth in emerging markets. Of course, this is Todd's area expertise. It's something of great interest to investors pretty much all the time.

So, Todd, I wonder if we could just start a little bit with maybe you can tell us how the emerging market landscape is changing at the moment.

Todd: I think you'll be surprised to know how much the index has changed over time. If we go back about 15 years ago when the emerging markets index was almost 40% weighted in energy and materials—sort of very heavy cyclical industrial type sectors—technology was really only about 10% or 12% of the index.

Now if you fast forward to today, it's been completely reversed, where technology is almost 40% of the index and

energy/materials have shrunk down to 10%, 12% of the index. So, the index has gotten much more tech-heavy whereas people have always thought of it as cyclical—exposed to energy, materials, metals, mining, things like that. That's really not the case anymore. And I think valuations really haven't reflected that.

I mean, if you go back even to 2010 or so, China was about 20% of the index. It's now around 35% or so. So China is becoming bigger and bigger and that's likely to continue because there's a lot of capital markets activity; there's a lot of companies going public there; there's a huge domestic market.

Asia's becoming a bigger and bigger part of the index. You've seen Europe, the Middle East, and Africa (EMEA) and Latin America sort of shrink in importance in the index, and Asia in general (which would include Taiwan, [South] Korea, India, Southeast Asia) all becoming bigger in the index.

You just haven't had the growth in Latin America or the growth in EMEA. You haven't had the capital markets activity. You haven't had as many new companies becoming public.

Mike: So, I mean, investors are all about opportunity. Maybe you can talk to us about the expanding high-quality opportunity set in emerging markets.

Todd: We're focused at William Blair on what we call sustainable value creation. And sustainable value creation is really return on capital employed. Where do we find the companies with the highest return on capital employed globally?

If we look back to 2002, about 15% of the highest quintile of the highest-return-on-capital companies in the world were found in emerging markets. Now if we fast forward to 2021, that number's about 35%. So emerging markets is about 12% of the global index, but now about 35% of the top quintile of highest-return-on-capital-employed companies are in emerging markets.

Mike: So, when we started off this conversation, you were talking about tech. Are there other secular growth trends? Are there other sectors you're seeing opportunity in?

Todd: Through the 1990s and 2000s, in a lot of emerging markets, it was a focus on consumer. And that's still true. We do focus on—as disposable incomes increase, people are going to spend more money on instant coffee, on beer, and yogurt, and spirits, and health foods, and things like that.

But we're probably less focused on the sort of Procter & Gamble type companies than we used to be, because emerging market 2.0—from the mid-2000s to date—is a bit more focused on e-commerce, on platform companies, on digital platforms. So we have much bigger exposure to companies doing e-commerce, doing fintech, gaming, things like that.

Mike: All right. We've been talking about secular trends that are driving growth in emerging markets with Todd McClone. Todd, thanks so much for your time.

Todd: You're very welcome.

Todd McClone, CFA, partner, is a portfolio manager for William Blair's emerging markets strategies.

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