Emerging Markets Roar Into the 20s

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Emerging markets (EM) equities and debt suffered along with other assets when the COVID-19 pandemic set off a global economic shock. As we look ahead, it is important to understand where we are—a global economy in the midst of a pandemic, but also one with significant opportunity and hope.

In 2020, the human race faced substantial obstacles but also showed resilience, ingenuity, and agility. In physical isolation, we celebrated the power of human connection. Those of us who believe that sitting across a table from decision-makers, embedding ourselves in economies, and visiting company operations are critical to solid decision-making look forward to these experiences again.

But perhaps 2020 was also a lesson: our physical stillness allowed us to connect in new ways. Individually and together our teams did just that. It is at the height of uncertainty when experienced teams can prove their mettle, looking for opportunities to use volatility to their advantage, leaning in when others are running away, and relying on time-tested investment frameworks and expertise.

While the investment world concentrated on vaccines, Brexit, trade wars, and the economic implications of the stop-start lockdowns, the Chinese equity market[1] quietly outperformed, rising 40% for the calendar year. Led by Asia, EM equities[2] more broadly rose by approximately 18%, outpacing developed market equities.

With the pandemic, developed market monetary policy became even more accommodative, bolstered by substantial fiscal policy support, both of which are expected to continue in the intermediate term. This environment has made the search for yield even more focused, and EM debt[3] was the natural beneficiary, yielding 4.53% with a historical default rate of 1% (compared with U.S. high-yield credit,[4] which yielded 4.18% and had a historical default rate of 3%).

Regardless of 2021's trajectory, one 2020 theme will undoubtedly persist. Concerns about sustainability—of our planet, infrastructure, societies, and institutions—will endure long past this year. The importance of these concerns cannot be overstated, as they affect both growth opportunities and risk.

A focus on sustainability underpins our investment processes at William Blair, which includes strong and/or improving governance expectations of companies and countries. Central to the dialogue is a focus on a wider array of stakeholders, increasing pressure for more diversity in leadership and boardrooms, and an accelerating emphasis on climate issues.

This is not news to European investors and pockets of investors elsewhere, but we expect adoption and engagement to accelerate globally with significant investment implications in emerging and developed markets alike. As investors, we must dig deeper and engage to understand intent, execution, and trajectory.

In our white paper—"Emerging Markets: Looking Ahead"— our teams discuss both the opportunities and risks for EM equity and debt, with a specific spotlight on China, given its increasing market heft.

We believe the EM equity opportunity is stronger than it has been over the past decade because of a confluence of internal and external factors. With the low-yield environment, EM debt, particularly the higher-yielding segment of the market, also provides unique opportunities for discerning, experienced investors.

Over time, while new growth leaders will undoubtedly abound across markets, asset classes, sectors, and continents, uneven growth and disparities in economic opportunity across countries will remain a focus and potential risk.

As we turn our eyes to the months and years ahead, will developed market accommodative fiscal and monetary policy, improving economic fundamentals, and pent-up demand—underpinned by a global vaccine rollout with unprecedented speed and collaboration—lead to a new Roaring 20s?

Perhaps, but regardless of what the next 12 months hold, what we do know is that while there are risks, EMs remain an exciting area for growth and provide significant opportunities for long-term investors.

Emerging Markets Series

Part 1: Emerging Markets Roar Into the 20s
Part 2: 2021: The Strongest Growth in a Generation?
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Part 7: China’s Unwavering Growth Journey

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[1] MSCI China A Onshore Index (net)

[2] MSCI Emerging Markets IMI Index (net)

[3] J.P. Morgan EMBIGD yield to worst as of 12/31/20; historical default rate is since 1983 and is estimated by Moody’s.

[4] Bloomberg Barclays U.S. Corporate High Yield Index yield to worst as of 12/31/20; historical default rate is since 1983 and is estimated by Moody’s.

The **Bloomberg Barclays U.S. Corporate High Yield Index** measures the U.S.-dollar-denominated, high-yield, fixed-rate corporate bond market. The **J.P. Morgan Emerging Market Bond Index Global Diversified (EMBIGD)** tracks the total return of U.S.-dollar-denominated debt instruments issued by sovereign and quasi-sovereign entities. (Index information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The indices are used with permission. The indices may not be copied, used, or distributed without J.P. Morgan’s prior written approval. Copyright 2020, JPMorgan Chase & Co. All rights reserved.) The **MSCI China A Onshore Index** captures large- and mid-cap representation across China securities listed on the Shanghai or Shenzhen exchanges. The **MSCI Emerging Markets (EM) IMI Index** captures large-, mid-, and small-cap representation across 27 EMs. Index performance is provided for illustrative purposes only. Indices are unmanaged and do not incur fees or expenses. A direct investment in an unmanaged index is not possible. Past performance is not indicative of future returns.

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