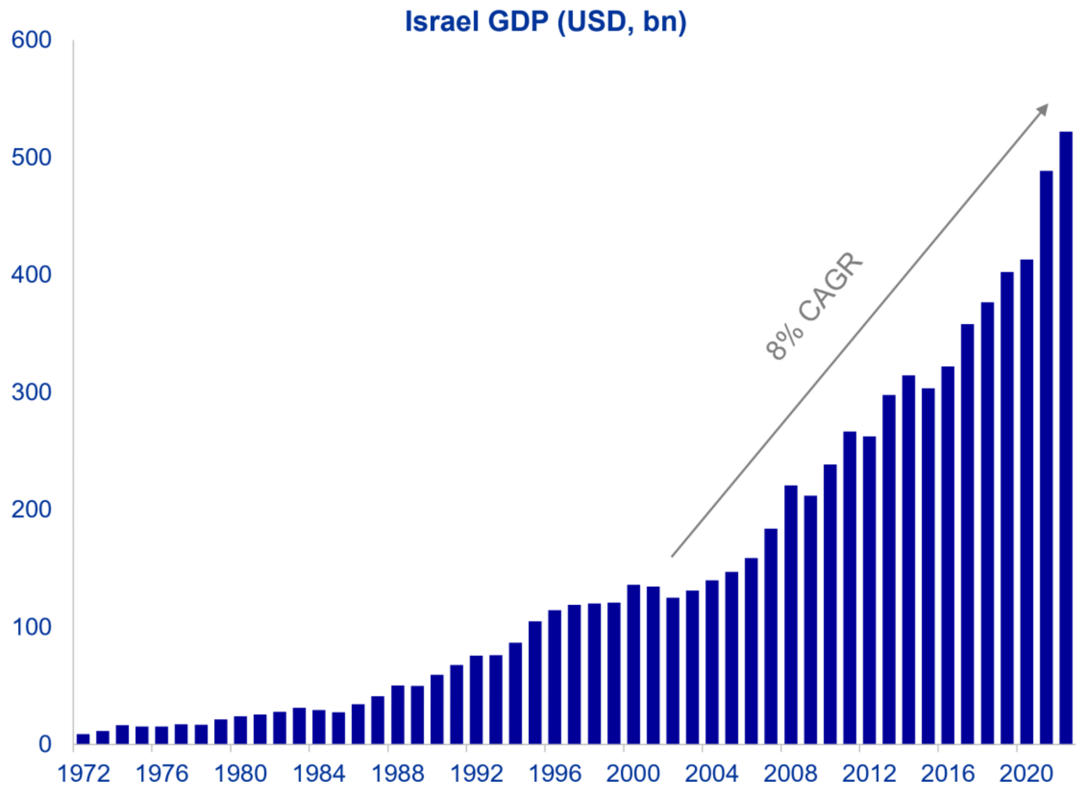
OP Insights – EM News in Focus

Attack on Israel

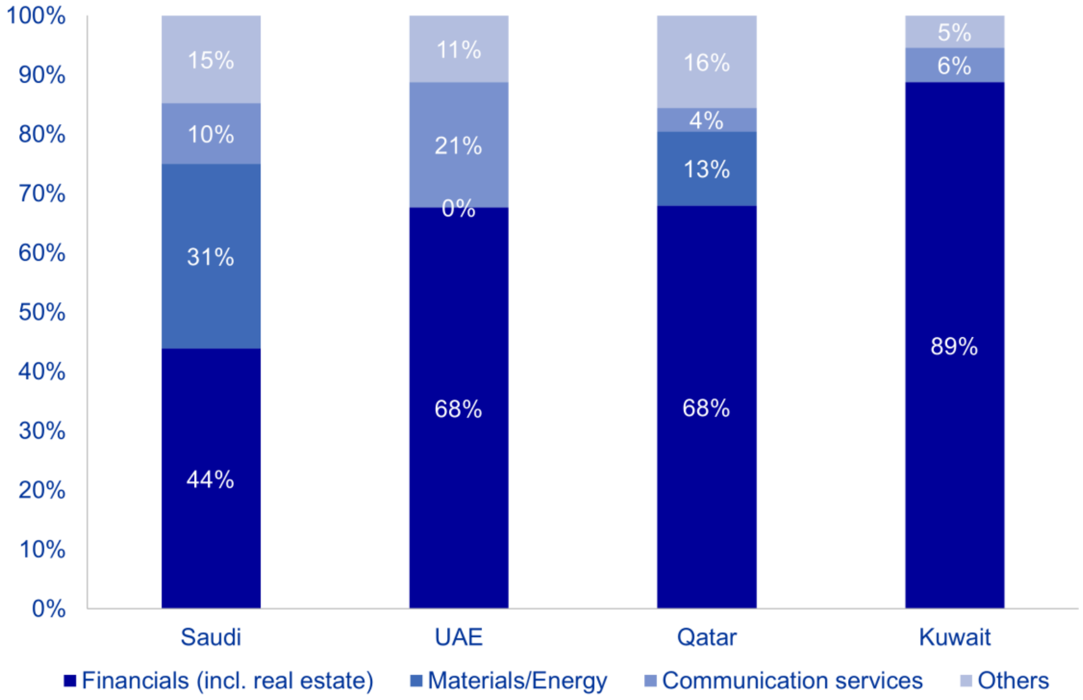
The Arabian Peninsula has never been a geopolitical wall flower when it comes to global activity. Yet the October 7th attack on Israel is truly shocking by any standard, and at a personal level we are deeply saddened. For context, the country enjoys per capita wealth similar to the EU average, and a thriving high-tech industry has given rise to the nickname 'Start-Up Nation". For Emerging Market investors, the market used to be classified as 'Emerging', but in 2010 transitioned to 'Developed'. The economy however has remained growing, and indeed over the past two decades has risen at an 8% USD CAGR.



Source: World Bank, 1972-2002.

While Israel may no longer be considered as 'Emerging', the region within which it sits most certainly is. Approximately 7% of the MSCI index is exposed to companies operating on the Arabian Peninsula, with key markets being Saudi Arabia, UAE and Qatar. While some of these countries have higher per capita wealth levels than many developed markets, there is often severe wealth inequality. They invest heavily, and there have been periodical large swings between economic feast and famine. Over the more recent decade, these countries have been accelerating efforts to diversify beyond oil-based growth in an attempt to reduce volatility and sustain national welfare in an era of energy transition. For example, the Saudi 2030 vision published in 2016 set out targets to realise a six-fold increase in non-oil government revenue.

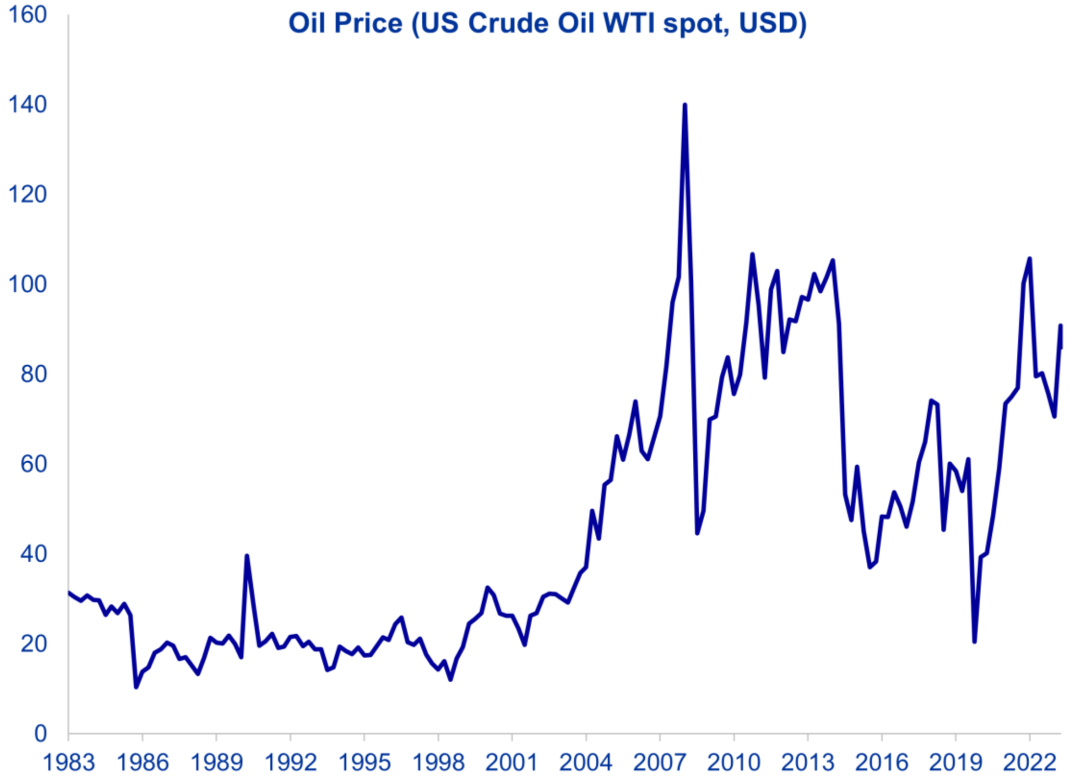
MSCI country index weights by sector



Source: MSCI country factsheets, September 2023.

Our Emerging Market equity strategy currently has no direct exposure to these markets. While we continue to review companies in the region, the challenge we find is that although headline market multiples may appear attractive, the underlying holdings exposure is largely from banks, telecoms, and commodities. In the case of banks, we continue to favour having a zero weight in this historically highly cyclical space, and in the case of telecoms and commodities we can find businesses at far more favourable valuations elsewhere in Emerging Markets.

Indirectly, there is some second order impact of recent events on the EM portfolio. This namely effects portfolio holding Petrobras, a Brazilian oil and gas producer. Regional hostility risks creating oil supply concerns, thereby pushing the oil price higher. This could be exacerbated in the instance that Saudi Arabia is put under pressure to reaffirm solidarity with the Palestinian cause. This would consequently create a heightened risk of tensions with the ‘West’. As we noted in our Quarterly newsletter, Petrobras remains one of the most attractively valued global oil major by most key measures – most notably, its total cash return yield. Operationally, the firm couples a low-lifting cost protecting on the downside, with ongoing exploration of the Brazilian pre-salt fields providing opportunity for growth. The valuation case for the firm remains attractive at a materially lower oil price than the current level.



Source: Bloomberg, October 2023.

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The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance