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Emerging Markets Spotlight

FOR PROFESSIONAL INVESTORS ONLY

James Syme, JOHCM Global Emerging Markets Opportunities

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"Technological advancement, measured by the long-term change in the relative price of investment goods, together with the initial exposure to routinization, have been the largest contributors to the decline in labor income shares in advanced economies"

IMF World Economic Outlook, April 2017

Whilst much of our focus is on conditions and developments in the emerging world, we must not lose sight of how changes in the advanced economies create opportunities and risks for our investments. It is from this perspective that we note the rapid rate of change in the US retail industry and its industry-specific and global implications.

2017 is proving to be the most brutal year for the industry since 2008. Credit Suisse estimate that there will be 8,600 store closings this year, compared to the 2008 historical peak of 6,200. High-profile bankruptcies and mass job layoffs have dominated the sector's news, yet the economy remains healthy. US retail sales (ex-food, auto dealers, building materials and gas stations) rose 3.4% in the year to March 2017, compared with an overall 3.4% fall in 2008. Consumer confidence is at its highest in sixteen years. The problem is not one of demand, but of competition.

Amazon stood out in the stream of negative news year-to-date, announcing plans to hire 30,000 part-time workers at the same time as reporting first-quarter revenues of USD 35.7bn, up 23% on a year earlier. The US retail industry, particularly in non-perishable goods, is being aggressively disrupted by online competition. The disruption in terms of jobs, companies and properties is severe, and this pattern is likely to spread to both other industries in the US and other countries. We feel this has three important implications for investors in emerging markets.

The first is to recognise the opportunity that online operators have in emerging markets. Three of the world's five largest internet companies are Chinese, with Tencent and Alibaba in particular going from strength to strength. We hold significant exposure to both.

In addition we have holdings in Naver in Korea and Naspers in South Africa (which, as well as a stake in Tencent, has significant internet assets in other emerging markets, notably India). Where we hold retail-type companies, we have ensured either that they are predominantly in the safer perishables sector (such as Eurocash in Poland, and Lenta and Magnit in Russia) or have strong online presence (such as M-Video in Russia, and Haier Electronics in China, both of which specialise in logistics and delivery of electrical and electronic goods).

The second is to look at the technologies that support the online world. We have holdings in Samsung Electronics, SK Hynix and Taiwan Semiconductor, all of which have benefited from the significant demand for memory and processors in servers. We also own Lenovo in China, which took over IBM's x86 server business. Additionally, a holding that we are particularly excited about is Reliance Industries which, as well as its energy and petrochemical assets, owns and operates India's first 4G telecom network, with mobile internet speeds of double its nearest competitor. We see mobile internet in India as one of the most exciting opportunities in the emerging world, and Reliance as a key beneficiary.

The third impact, which is more global in nature, is to recognise (as per the IMF quote above) that technology remains a major global deflationary force. If developed market growth is to be both slower and less inflationary than in the pre-2008 period, emerging markets, which variously offer higher growth rates and/or higher yields, are likely to be the recipients of significant capital flows from the developed world.