



The case for emerging markets

Take advantage of shifting global dynamics

Emerging markets (EM) have been growing rapidly in recent years. In fact they now represent nearly 60 percent of global growth and more than 50 percent of global GDP. Once dominated by agriculture and cheap manufacturing, EM countries are today home to some of the world's fastest growing economies and most innovative companies.

What is an emerging market?

An emerging market economy is simply one transitioning from low-to-middle income to high income. However, unlike a frontier economy, an emerging market economy already shares some of the characteristics of a developed market. This includes a functioning stock exchange where shares can be easily traded, access to debt and some form of predictable government regulation – all of which help smooth its path to development.

EM economies include growing powerhouses such as India, Indonesia, Brazil and China, as well as smaller more nimble economies like Morocco, The Philippines and Thailand.

The rise and rise of emerging markets

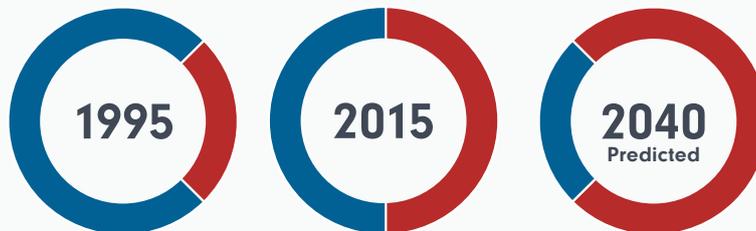
As trade and production become more integrated, emerging markets have become more and more important to the way the global economy functions.

A quick look at the labels in your wardrobe or the appliances in your kitchen makes it easy to understand that China now produces more than 25% of everything manufactured around the globe. But other developing economies are powering ahead too. For instance, South Africa is a leading producer of motor vehicles, as well as precious metals, iron and steel. Brazil is home to four of the world's 100 largest banks, as well as Embraer, the world's third largest aircraft manufacturers.¹ And India's economy is booming to the point where merchandise exports and imports grew 11.02% and 21.04 % respectively in the year to February 2018.²

As money flows in, these economies are beginning to account for a much higher percentage of global GDP. In fact, 'The World in 2050' a PWC report into the growth of the 'E7', (the seven largest emerging market economies) showed that in 1995 these nations had a combined GDP less than half that of the G7 (the seven largest advanced economies). By 2016, the two were level.³

Projected change in shares of world GDP

- Developed[†]
- Emerging[‡]



However, by 2040, it's estimated that emerging economies will have an output that is double the developed world. In other words, in the space of 45 years emerging markets will have gone from a peripheral position in the world economy to a central one.

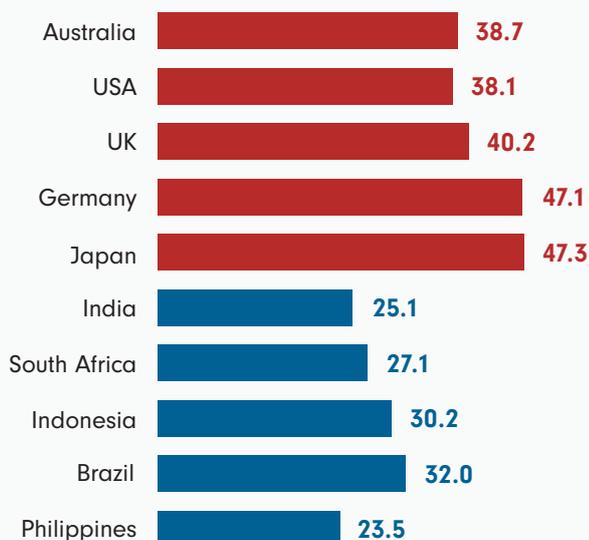
Despite this, they still account for just a fraction of most Australian investment portfolios.

A demographic shift

If you're wondering why emerging markets are experiencing such solid growth, you've hit upon the second part of the emerging markets equation – many emerging markets are undergoing a profound demographic shift.

While much of the developed world struggles to come to terms with the cost of supporting an aging population, developing economies typically don't have this problem as much of their population is still young. For example, India has a median age of 27.9, compared to the EU median age of 42.6 which means there are still plenty of productive workers to keep the economy running and fewer retirement age workers to support.⁴

Median age



As more of these productive aged workers find meaningful work, they also tend to have more disposable income which means we're seeing a new middle class rising out of emerging market economies. Between 2009 and 2030, China alone is expected to add 850 million people to its middle class, in the process taking it from 12% of its population to 73% of its population.⁵

“ Business confidence and conditions are above long-term averages... ”

With this increased affluence comes increased consumption – not just of consumer goods such as cars, technology and electrical goods, but of more sophisticated products and services. China's healthcare industry for example grew four-fold between 2006 and 2016. China is now also the second largest global market for financial services – behind only the United States – with home loans, deposits, life insurance and investment advice all becoming more integral to the way the economy functions and people live their lives.⁶

Investment pouring in

So while emerging markets started with manufacturing and exporting, domestic consumption is becoming an important economic driver. As it does, emerging markets become less reliant on the developed world and their businesses become less correlated with Western ones.

That means emerging market equities don't just offer Australian investors growth potential, they also increasingly offer genuine diversity and possible protection from an economic downturn in the developed world. Furthermore they're good value – EM equities currently trade at around a 25% discount to what we would pay for equivalent investments in more advanced economies.

[†] Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

[‡] China, India, Brazil, Indonesia, Russia, Mexico and Turkey.

For these reasons, many established businesses, as well as institutional investors, are beginning to see that investing in emerging markets is a vital part of both their growth and risk management plans.

“ Emerging markets increasingly offer genuine diversity and possible protection from an economic downturn. ”

The importance of active management

Given emerging markets are often less stable and transparent than more advanced economies, it's important to help mitigate risk by creating a diversified portfolio and select companies that are well positioned to generate returns through the ups and downs of market cycles.

At Fidelity we believe an active investment approach offers crucial advantages for investors as it allows our investment team to select opportunities from a much broader universe than those available in the Index.

The advantage to investors is two-fold; greater diversification across countries, sectors and companies which helps reduce risk and importantly provides more opportunities to create meaningful value.

What sort of companies can you access?

Today EM economies are home to some of the world's most innovative companies such as China's Alibaba or Samsung in Korea. Many of these companies are also positioned to benefit from the structural shifts or demographic trends that many emerging markets are experiencing.

Let's look at an example:

Bank Central Asia: Invest in the bank that's financing Indonesia's growing middle class

Bank Central Asia (BCA) is Indonesia's largest bank by market value, with a market capitalisation of approximately \$A52 billion. In 2017, it outperformed market expectations, with profits rising by 13%, largely due to in Indonesia's expanding mortgage market. It's now South-East Asia's largest lender.

BCA has a long heritage and is closely bound to the country's economic performance. It was founded in 1955 but its real success came as a result of the Asian Financial Crisis, while other financial institutions fell, BCA re-invented itself, with a change of ownership and a renewed focus on employee and customer engagement.

The bank has established itself at the forefront of Indonesia's financial services market, servicing both individuals and businesses. With the same management team in place for almost two decades, it offers a diverse range of loan and deposit products - in much the same way as Australia's Big Four banks.

Importantly, with the Indonesian economy expected to rise spectacularly over the coming years, BCA is expected to provide much of the private finance that will fuel the countries development.

Like to know more?

If you'd like to know more about the Fidelity Emerging Markets Fund, visit our website or call or email our client services team:

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1 Source: S&P Global Market Intelligence

2 Indian Ministry of Commerce & Industry.

3 PWC report "The World in 2050"

4 The World factbook

5 2010 OECD working paper

6 www.mckinsey.com



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