



# Dynamic Growth Stories Where Nobody is Looking

Latin America, Emerging Europe, Middle East & Africa

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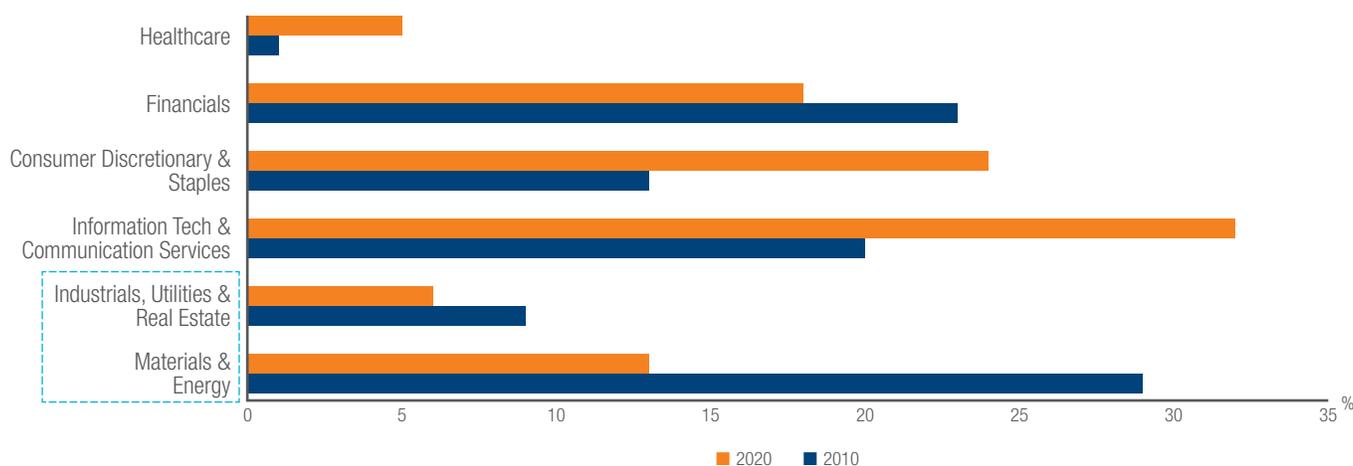
**Latin America and EEMEA (Emerging Europe, Middle East, and Africa)** have grown into attractive but overlooked regions of Emerging Markets (EM). The average global institutional equity investor has a 5% allocation to Emerging Markets.<sup>1</sup> With Asia currently representing 80% of the MSCI EM Index,<sup>2</sup> the average global investor only holds a 1% allocation to Latin America, Emerging Europe, the Middle East, and Africa combined. This leads us to believe that most investor attention remains on Asian markets, potentially creating inefficiencies and opportunities in Latin America and EEMEA. Simultaneously, these are the regions seeing some of the largest structural leaps across the emerging world.

When thinking of Latin America and EEMEA, many market participants immediately jump to energy and materials. This assumption makes sense considering that the two sectors represented about 30% of the MSCI EM index only a decade ago. Today, that number has more than halved to roughly 12%. In just a decade, the landscape has changed dramatically.

In general, EM economies have shifted away from asset-heavy low return industries like manufacturing, construction, and commodities and towards services, innovation, and high return business models. This opportunity is especially true across Emerging Markets outside of Asia. For example,

Russia is not just an oil story anymore. Russia's tension with the US has kept some Western companies from entering the country, which has created opportunities for domestic stories to develop significant first mover and provided competitive advantages. Russia Search Engine and Ride Sharing giant, Yandex, represents 9.0% of the MSCI Russia Index and continues to dominate the powerful online trends across Russia. Despite nascent stages of online shopping penetration, Brazil boasts a dynamic e-commerce landscape. High growth companies like Magazine Luiza, B2W, Sequoia, and Locaweb are building out impressive ecosystems in Brazil that will continue supporting the powerful shift from brick-and-mortar to online going forward.

**MSCI EM INDEX SECTOR WEIGHTINGS, 2010 VS. 2020**



Source: Bloomberg. As of December 31, 2010 and December 31, 2020.

<sup>1</sup>EPFR Global, Thomson Reuters Datastream, HSBC calculations, data as of 11/30/20.

<sup>2</sup>Bloomberg, data as of 12/31/20.

## Structural Themes

As these economies shift to more profitable business models, they could potentially create higher-paying jobs, which creates more discretionary income, and could lead to higher standards of living. All of this can create a self-fulfilling cycle as EM participants drive incremental demand for additional products and services, which generates opportunities to invest in new themes across their markets. Some examples include:

**Financial Inclusion and digital banking:** There are significant opportunities in underbanked countries, where online banking and mobile money are not only bringing in more customers but are also creating opportunities for banks to cut costs, increase cross-selling, and improve credit books with more data. Mexico presents a strong example of this with only 22% credit penetration and only 3.4% mortgage penetration.<sup>3</sup>

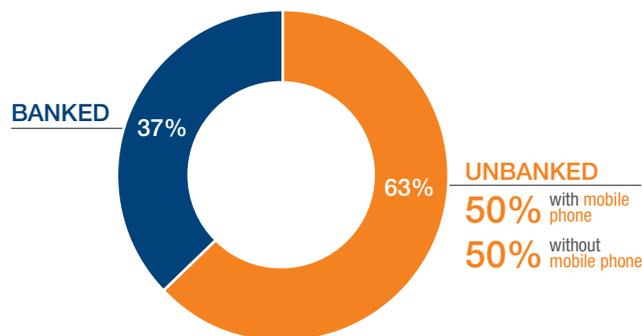
**Education and remote learning:** Brazil's illiteracy rate stands at roughly 7% for those over 15 years old.<sup>4</sup> On average, a Brazilian student spends 8 years at school, which is not enough to complete primary education and Brazil trails the rest of Latin America.<sup>5</sup> These challenges provide opportunities, as private education companies have emerged across the country. Most of these companies may benefit from economies of scale, as they implement technology to drive remote learning programs.

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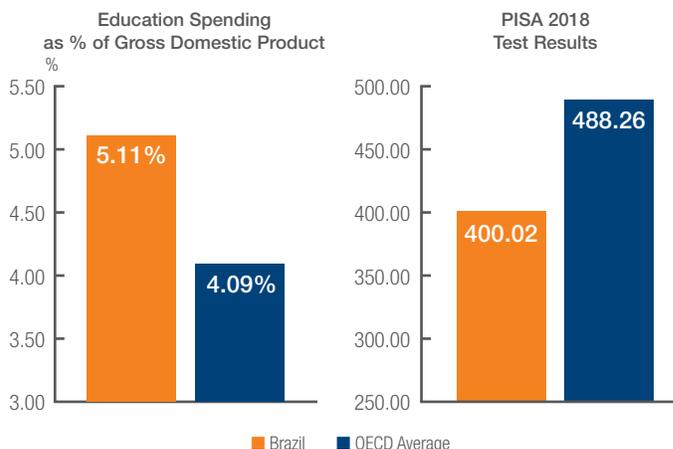
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### MEXICO'S MOBILIZED UNBANKED POPULATION



Source: The World Bank, "The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution".

### ABOVE AVERAGE EDUCATION SPENDING IN BRAZIL, BELOW AVERAGE QUALITY



Source: OECD Brazil Education at a Glance, 2020; OECD PISA 2018.

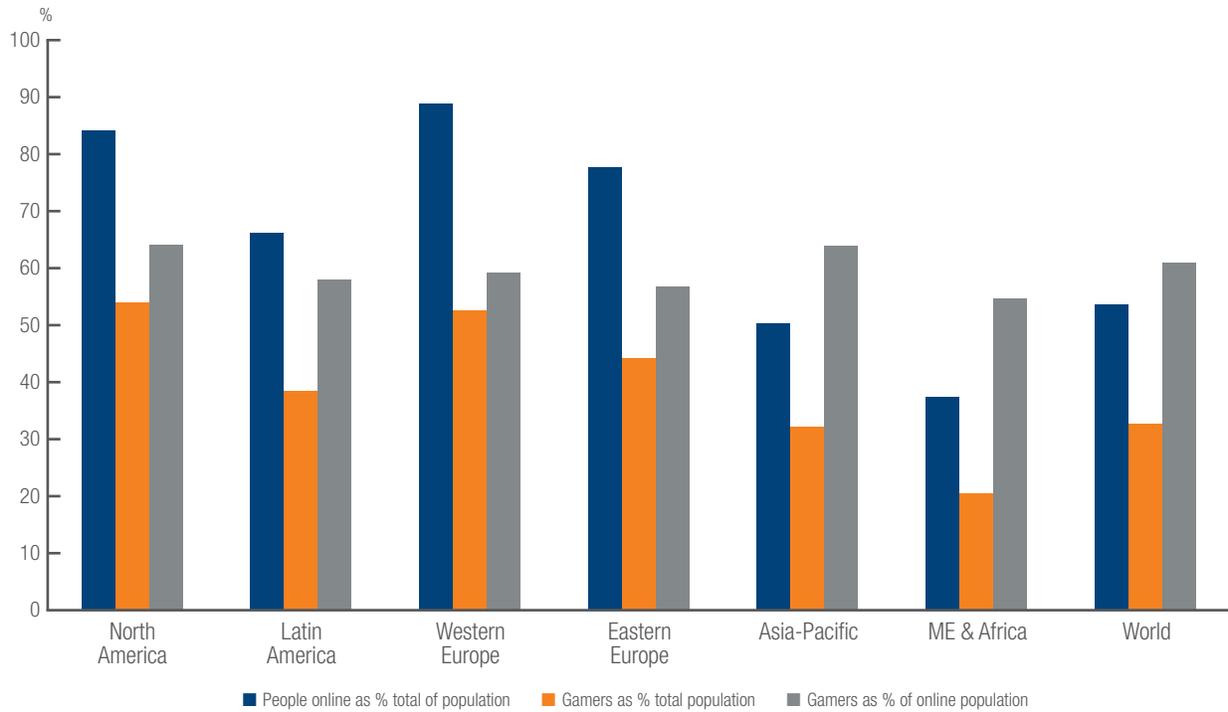
<sup>3</sup>Grupo Financiero Banorte Investor Presentation 3Q20.

<sup>4</sup>World Bank, September 2020.

<sup>5</sup>JP Morgan, "Brazil 101", February 2020.

**Entertainment and gaming:** Technological breakthroughs over the past decades have allowed programmers to disrupt entertainment as we know it. With mobile phone’s ubiquitous presence, gaming has finally arrived on the world stage as consumers in emerging markets joined the competition. The video game market is booming in emerging Europe. Polish video game creators represent roughly 10% of all market cap in the country.<sup>6</sup>

**GAMERS AS A PERCENTAGE OF THE POPULATION**



Source: Newzoo Global Games Market Report, 2019.

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<sup>6</sup>Bloomberg, as of January 21, 2021.

## Rapidly Changing Environment

Latin America and EEMEA country representation in the EM benchmark looks different today than it did ten years ago. New countries have entered the benchmark creating more diversification and more opportunities for stock selection. These countries include Argentina, Saudi Arabia, Qatar, Kuwait, and Greece.

Asia has been a central theme for EM over the last decade, growing from 58% to 80% of the MSCI EM Index. Latin America and EEMEA have shrunk with negative commodity momentum and halved their EM representation from 42% to 20%. That said, new companies have begun to fill in the gaps left open from “old economy” companies in the regions. The 2020 low interest rate environment has led to a boom in capital markets. In 2020 alone, Brazil offered over 50 deals raising US\$8.4bn in equity.<sup>7</sup> Though Asia’s significant market cap and benchmark weighting continue to hold the market’s attention, we see dynamic opportunities across the rest of the emerging world that should garner forthcoming attention and flows.

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## Latin America Today

As a region, Latin America should uniquely benefit from a Covid-19 vaccine driven rally. Advances in vaccine development and distribution could boost investors’ risk appetite, which would help commodity exporters such as Peru, Chile, and Brazil. Colombia would likely benefit from a recovery in oil prices, which could offset the country’s fiscal woes. Although policy uncertainty could present a headwind, Mexico could stand to benefit from a stronger relationship with the US stemming from the United States-Mexico-Canada Agreement (USMCA) and supply chain adjustments. Brazil stands out as a distinct growth story driven by significant monetary easing and fiscal reforms. Despite headwinds from social unrest and political instability in Peru and Chile, Peru has shown to be attractive from a valuation perspective and Chile should be supported by low rates and their strong Covid-19 response. Despite the positive outlook on the region, Argentina’s forecast remains clouded due to concerns over a return to subsidy-led wealth distribution and conflict with the IMF.

## EEMEA Today

Emerging Europe has had some of the most attractive valuations across global equities. Russia, Saudi Arabia, and much of the Middle East seem well-positioned to benefit from a sustainable rebound in energy prices along with an improving global geopolitical picture. South Africa should be a key beneficiary of China’s growth story and marginal improvements in its political outlook. In Turkey, we believe the market remains concerned about Central Bank independence and orthodoxy but could move quickly with recent improvement signs. We believe that Central Europe’s outlook heavily relies on the economic picture in Western Europe. Overall, the region trades at depressed multiples with realistic near-term catalysts to drive re-ratings.

<sup>7</sup>Bloomberg, December 2020.

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### Important Information and Definitions

**PISA** is the OECD's Program for International Student Assessment. PISA measures 15-year-olds' ability to use their reading, mathematics and science knowledge and skills to meet real-life challenges.

**MSCI Emerging Markets Index** captures large and mid cap representation across 26 Emerging Markets (EM) countries.

**MSCI Russia Index** is designed to measure the performance of the large and mid cap segments of the Russian market.

**MSCI Brazil Index** is designed to measure the performance of the large and mid cap segments of the Brazilian market.

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