

## Progress Check on Emerging Markets

What happens as developing markets develop?

We are experiencing one of the most tumultuous market periods in decades, and investors are revisiting assumptions that guided them through the last era, **regardless of where or what they're trading**. Rates have risen precipitously, private market down rounds are hitting 5-year highs and the global war on inflation is still raging.<sup>1</sup> Macroeconomic and geopolitical headwinds have flipped portfolios on their heads, and investors are reassessing their exposure levels and asset allocations. Institutions are searching far and wide to meet return targets, and some are reviewing a strategy thought to promise growth, but one that comes with its own set of headwinds and questions – **emerging markets**.

**Emerging markets look very different in this era than in 2001**, when the concept of 'BRICS' was first introduced. From an economic perspective, the BRICS countries – Brazil, Russia, India, China, and South Africa, now collectively contribute 31.5% of the world's GDP vs the G7's 30.7%, and have launched a New Development Bank as an alternative to the World Bank and the IMF.<sup>2</sup> From a policy perspective, the BRICS are trying to position themselves as an alternative allegiance, Russia has been declared 'uninvestable' by the West, China's zero-Covid response resulted in its lowest growth since the 1990's, and Brazil's central bank has been combatting double-digit inflation with aggressive tightening.<sup>3</sup> These fundamental shifts come at a time when the Middle East is flush with cash, as oil recently hit its highest level since 2008, and the US dollar has reached its highest level since 2002.<sup>4</sup> This has far reaching implications, not just for equity markets, but for debt markets, governments, currencies and private companies.

**How are emerging markets investors thinking about their investments?** They're taking the time to: **1)** re-evaluate what constitutes as an 'emerging market' in their portfolio **2)** review their investment goals and **3)** identify areas and asset classes best positioned for growth.

### EMERGING MARKETS: REGIONS BY THE NUMBERS

	World	US	China	Asia Emerging Markets Ex-China <sup>i</sup>	LatAm Emerging Markets <sup>ii</sup>	Middle East Emerging Markets <sup>iii</sup>
<b>GDP (\$USD)</b>	\$106 Tr	\$26.8 Tr	\$19 Tr	\$9.1 Tr	\$4.6 Tr	\$1.9 Tr
<b>GDP based on PPP (% of the world)</b>	N/A	15.4%	18.9%	15.0%	5.3%	2.2%
<b>Expected GDP Growth (2024)</b>	3%	1.1%	4.5%	4.3%	1.9%	2.9%
<b>GDP per Capita (\$USD)</b>	\$13,400	\$80,000	\$13,700	\$4,600	\$10,200	\$35,800
<b>Debt-to-GDP (%)</b>	N/A	122.2%	82.4%	55.3%	55.12%	26%
<b>Inflation – CPI (YoY) %</b>	7%	4.5%	2%	3.8%	7%	3.1%
<b>Population</b>	7.9 Bn	335 mm	1 Bn	2 Bn	453 mm	53 mm
<b>Population (% of the world)</b>	N/A	4.2%	12.7%	25.3%	5.7%	0.7%
<b>2021 Households Consumption (\$USD)</b>	\$52.9 Tr	\$15.9 Tr	\$6.8 Tr	\$4 Tr	\$2.4 Tr	\$581 Bn

Sources: IMF, World Bank

### EMERGING MARKETS: HISTORIC THEMES OF EACH DECADE

Each era of emerging markets investing has been shaped by the rise and fall of certain economies and sectors. Headlines may speak to emerging markets' performance as one asset class, but experienced investors know the various sub-markets within that have driven investment decisions. We are not sovereign debt specialists or political experts but can highlight some of the most relevant themes that have historically come up in emerging markets investor meetings, and those which may dominate discussions over the next decade.

**1990's:** Crises in Emerging Asian Debt and Currency Markets

**2010's:** Rise of China

**2000's:** Introduction of BRICS

**2020's:** Rise of India and the Middle East?

<sup>i</sup> India, Indonesia, South Korea, Malaysia, Philippines, Taiwan, Thailand

<sup>ii</sup> Brazil, Chile, Colombia, Mexico, Peru

<sup>iii</sup> Kuwait, Qatar, Saudi Arabia, UAE

## DOES CHINA BELONG IN ITS OWN CATEGORY?

The last decade of emerging markets investing saw China emerge as a dominant player. The country's extraordinary growth then ground to a halt in the wake of a zero-Covid policy, and recent geopolitical developments have investors unsure where to bucket China. Is it developed, still emerging, or in a class of its own?

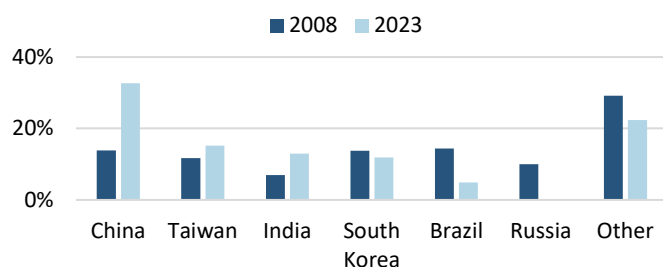
### China's Rise to Prominence

The Chinese Yuan recently hit its lowest level since 2008, but the country is in a very different place than it was 15 years ago.<sup>5</sup> In 2008, China was the 3<sup>rd</sup> largest economy, behind Japan, with an equity market totaling just \$1.78 trillion.<sup>6</sup> Fast forward to 2020 and China firmly secured its place as the 2<sup>nd</sup> largest economy with an equity market eclipsing \$12.2 trillion.<sup>7</sup>

China makes up almost 1/3 of the MSCI Emerging Markets Index, and some investors have started looking at ways to silo their China exposure from the rest of emerging markets. In 2023, the country is fighting a battle against deflation while most of its peers face inflation, it has the 2<sup>nd</sup> highest GDP in the world, and is diverging from the West geopolitically.<sup>8</sup> Bulls and bears alike increasingly view China in a league of its own, and Wall Street is considering if it's time to strip China from emerging markets indices.<sup>9</sup>

### MSCI Emerging Markets Index

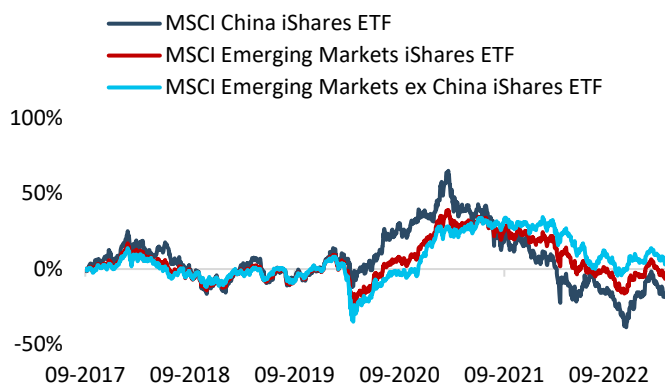
Country Weights



Sources: MSCI, Callan Institute

### Emerging Markets vs. China Performance

2H 2017 - 1Q 2023

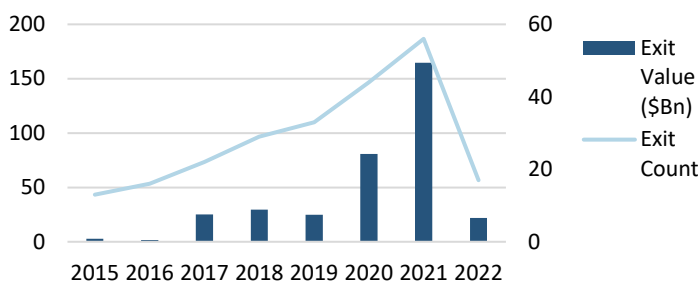


Source: Factset

## Spotlight on Private Markets in China

Private markets activity exploded over the last decade, and China represents the second largest PE/VC market in the world.<sup>10</sup> China VC exits with investors ex-China hit a record \$165 billion in deal value in 2021, but since then foreign investors have raised concerns around macro and governance uncertainty, such as recent offshore listing rules.<sup>11</sup> Some are hopeful China's lifted COVID restrictions may reinvigorate the private market environment, but it remains to be seen how actively investors will get involved in private deals while waiting for guidance from the China Securities Regulatory Commission (CSRC).<sup>12</sup>

### VC Exit Activity with Participation from Investors Outside of Greater China



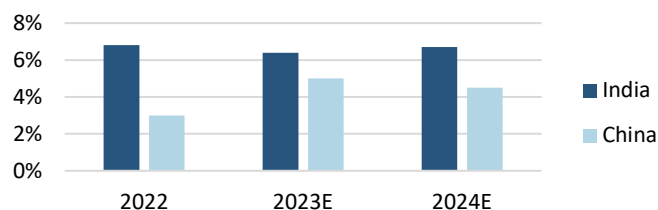
Source: PitchBook

### Is India the 'New China'?

If China shifts into a separate category from emerging markets, some investors are wondering if India is best positioned to step in and take its place. India has favorable economics and is forecast to surpass the population of mainland China for the first time this year.<sup>13</sup> Growth in India is observed across industries; supply chain shifts are opening doors for the country to gain market share and demand for tech talent is increasing domestic hiring. Multinationals are moving their factories from China – Apple now makes almost 7% of iPhones in India.<sup>14</sup> Large hedge funds like Millennium, DE Shaw, and AQR are expanding their India footprints, adding new offices, and hiring data scientists and engineers.<sup>15</sup> India outpaced China's GDP growth rate in 2022 at 6.8% vs. China's reported 3%, and India is on track to continue with a 6.7% projected growth rate in 2024 vs. 4.5% in China.<sup>16</sup> Jefferies' research sees India's private sector spending fueling additional growth, as one of the few countries with YoY declines in corporate debt-to-GDP ratios, corporate spending is expected to continue rising.<sup>17</sup>

### GDP Growth Rate

India vs. China

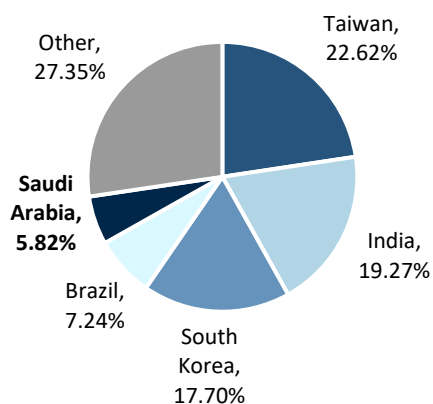


Source: ADB, Asian Development Bank

## IS THE MIDDLE EAST DOMINATING EMERGING MARKETS IN THE NEXT DECADE?

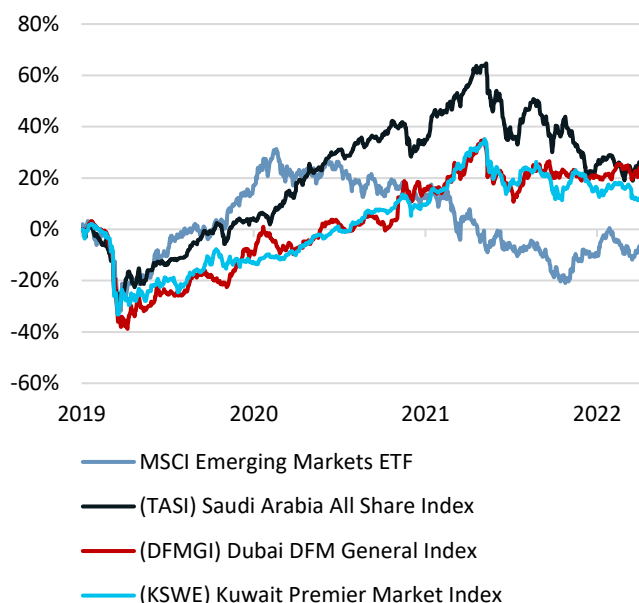
The growth of sovereign wealth funds, rise in oil prices, and new peace and trade agreements across the region has allowed the Middle East to make its mark on the global economy. Funds from Saudi Arabia, Qatar, Kuwait, and the UAE now manage more than \$3.5 trillion, which is more than the UK's GDP.<sup>18</sup> Coming off a decade-high record of nearly 6% GDP growth in 2022, investors wonder if the Middle East will continue to gain traction in emerging markets as they further diversify assets.<sup>19</sup>

### Saudi Arabia Now Makes Up Almost 6% of MSCI Emerging Markets Ex-China Index



Source: MSCI, Country weights as of 1Q2023

### EM vs Middle East Performance 2020 - 1Q2023



Source: Factset

## Is UAE (specifically Dubai) the Next Global Hub for Alternatives?

More than 60 hedge funds have said to be in current discussions to establish a presence in the Dubai International Finance Centre (DIFC).<sup>20</sup> There are now over 36,000 professionals employed there, with more than 6,300 employees joining in 2022 alone.<sup>21</sup>

### What's factoring into the recent middle east industry build out?

- ✓ **Close proximity to Sovereign Wealth Funds (SWFs)** – The Gulf region's 10 largest SWF's manage nearly \$4 trillion – more than the entire hedge fund industry.<sup>22</sup>
- ✓ **Concentration of wealth** – In 2022 the UAE saw the greatest inflow of millionaires in the world at over 4,000 HNWI's.<sup>23</sup> Qatar, the UAE, Kuwait, and Saudi Arabia all have GDP per Capita's above \$30,000, more than double China's figure.<sup>24</sup>
- ✓ **Favorable demographics** – In Qatar, Kuwait, the UAE, and Saudi Arabia, the average percent of the population between 15-64 stands at 78% versus the world's average of 65%.<sup>25</sup>

### How is the Middle East Diversifying its Oil Reserves?

Rising energy prices has left Middle Eastern SWF's flush with cash, and many recognize the opportunity to diversify now with this added liquidity. The region's wealth funds invested almost \$89 billion globally in 2022, double that of 2021.<sup>26</sup>

### What do SWF portfolios have more of now than a few years ago?

**Hedge Funds** – SWF's increased hedge fund holdings by 11% in 2022, bringing total assets in hedge funds to \$498 billion.<sup>27</sup>

**Venture Capital** – Saudi Arabia's SWF Sanabil just started their venture strategy in 2019, and now invests around \$3 billion each year, with a portfolio of 40 venture and growth equity firms.<sup>28</sup>

**Global Financial Institutions** – First Abu Dhabi Bank PJSC explored a bid for Britain's Standard Chartered Plc at the start of 2023, and Saudi's National Bank now holds 0.5% of UBS.<sup>29</sup>

**...And Soccer Teams?** Gulf investors have reaped social and economic benefits through owning Manchester City FC, Sheffield United FC, Paris-St Germain FC, and Newcastle United FC.<sup>30</sup>

### Abraham Accords Have Opened Additional Doors for the Middle East

New peace and trade agreements in the Middle East have increased the economic opportunities for emerging markets in the region. While Israel is classified as a developed market by MSCI, the Abraham Accords signed in 2020 between Israel, the UAE, Bahrain, Sudan, and Morocco, may generate four million new jobs and over \$1 trillion in economic activity for the signatories.<sup>31</sup> As a result, Israel and the UAE have already signed a free trade agreement to expand bilateral trade to \$10 billion by 2027.<sup>32</sup> Budding relationships and new activity is expected to enhance business deals, cultural exchanges, healthcare partnerships, and joint initiatives to promote security, peace, and prosperity in the region.<sup>33</sup>

## KEY CONSIDERATIONS FOR EMERGING MARKETS PORTFOLIOS IN A NEW INVESTMENT REGIME

Given the macroeconomic uncertainty and shifting geopolitical sands, investors are going back to the whiteboard when it comes to their emerging markets portfolios. They are reviewing their overall exposure to emerging markets, revisiting best execution strategies and managed products, and are reconsidering various risks and hedging approaches.

### Selected Drivers for Emerging Markets Exposure

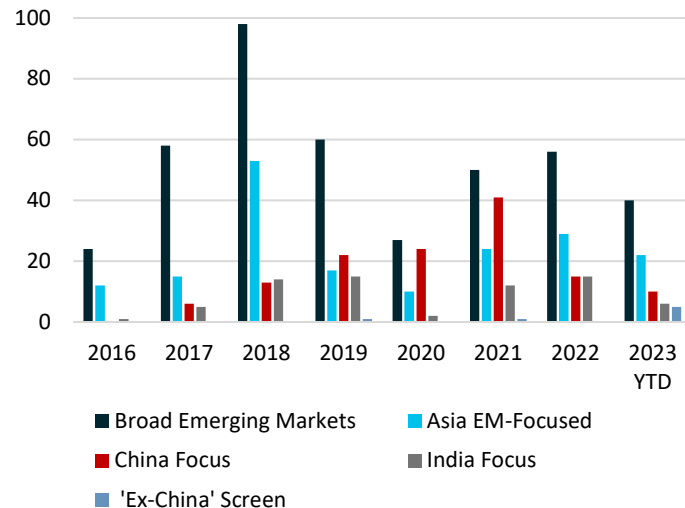
Beyond the return opportunity, investors may choose to allocate to emerging markets for a variety of reasons, including asset and regional diversification. Before determining the best areas and products for exposure to emerging markets, one must first determine the main investment goals.

- ✓ Absolute Growth?
- ✓ Uncorrelated exposure to developed markets, like the US?
- ✓ Seeking more expansionary monetary policy?
- ✓ Attractive valuations?
- ✓ Idiosyncratic, alpha-generating opportunities?

### Selected Paths and Instruments for Emerging Markets Exposure

Investors have a diverse menu of options to select from when putting on exposure to emerging markets, as funds in this space tend to specialize across asset classes and regions. Jefferies Capital Intelligence team has tracked LP searches for emerging markets-focused funds, with a notable amount of specialized regional searches for Asia – particularly China and India. Emerging markets products of choice for investors varies between passive and actively managed (mutual funds and ETF's vs. hedge funds), and securities beyond equities, such as options, sovereign and corporate debt, commodities, and private markets.

### LP Mandates for Emerging Markets Funds



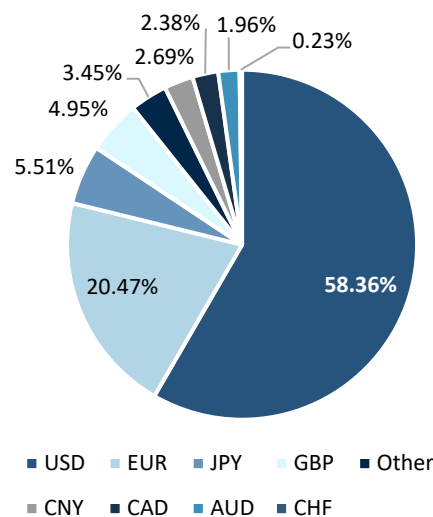
Source: Jefferies Capital Intelligence

## Emerging Markets Risks to Consider – Currency and Geopolitics

Investments in emerging markets come with currency risk, geopolitical risk, and sometimes uncertain rules of law, all during a challenging macroeconomic environment. Entering 2023, the US dollar reached its highest level in decades, and investors have been forced to actively manage and hedge emerging market risks.

Some investors have been particularly interested in local currency denominated debt as a path to put on emerging markets exposure.<sup>34</sup> This is a large and growing asset class, with inherent risks of its own, but massive potential for FX appreciation.<sup>35</sup> The risk to hold local currency bonds offers promising returns but without the safety backstops that come with the world trade leading currency. Latest measurements of foreign exchange reserves across the globe shows that USD still accounts for nearly 60% of total central bank reserves.<sup>36</sup>

**Total Central Bank Reserves by Currency**  
As of 4Q 2022



Source: IMF

**You don't have to be a political scientist to know we're in a global period of transition.** Emerging markets make headlines nearly every day, with updates on shifting world alliances, groundbreaking political election outcomes, and newfound trade agreements. In transitional periods, investors typically re-evaluate their high-level exposures and outlooks, and end up with several top-down questions regarding portfolio management and construction. Our comprehensive, but non-exhaustive research on emerging markets is meant to help allocators as they revisit their exposure and help inform emerging markets managers of investor sentiment as they engage in fundraising discussions. We have highlighted regions which have seen immense growth, and those that may be positioned to benefit from tailwinds going forward, but as with all international investments, these views are subject to ongoing geopolitical and macroeconomic uncertainty.

## HOW JEFFERIES CAN HELP

Jefferies is a full-service investment bank and capital markets firm, with 5,000+ employees providing insight, expertise and execution to investors, companies and governments. We offer deep sector and regional expertise across a range of products and services in investment banking, equities, fixed income, and wealth management in the Americas, Europe, the Middle East and Asia, across 40+ offices.

### Jefferies Emerging Markets Offering

Jefferies is an active participant and partner in emerging markets across the Americas, Europe, the Middle East, and Asia, with offices found in the following cities: **Dubai, Hong Kong, Beijing, and Mumbai.**

- **Research Alliances:** Jefferies boasts research alliances with leading brokerage firms in emerging markets, including groups in **Taiwan, Malaysia, South Korea, Indonesia, the Philippines, Thailand, and South Africa.** These joint partnerships allow Jefferies clients access to top research and strategy coverage in these regions, while we offer one of the largest distribution networks for emerging markets, covering a broad range of institutional investors, and offering access to trading flows and liquidity.
- **Fixed Income:** Jefferies is a market-maker and active participant in hard currency sovereign and corporate fixed income markets across **Latin America, Eastern Europe, the Middle East, Africa and Asia.** Jefferies experience and long-standing, high-quality relationships allow us to utilize our balance sheet and provide the highest quality liquidity and intellectual capital to our clients globally.
- **Banking:** With offices in 40+ cities around the world, Jefferies provides a full range of investment banking services, including equity capital markets, debt capital markets, mergers and acquisitions, and restructuring and recapitalization services. The firm has been building out a **presence in the Middle East**, with a recently opened office in **Dubai** and office opening soon in **Tel-Aviv.** *While Israel is considered a developed market by the MSCI, it is geographically proximate to emerging markets in the Middle East*, and our dedicated banking coverage teams have deep connectivity with the top deals and players across the region.

The **Jefferies Capital Intelligence team** leverages proprietary data from institutional allocators and hedge fund managers to extrapolate trends around capital allocations and portfolio construction. The team has a regional coverage model and has dedicated personnel covering emerging markets managers and allocators across Europe, the Middle East, and Asia. The team has a unique vantage point for understanding the nexus between investors and fund managers during a time of global economic transition. The norms of the last decade plus are shifting, leading to new opportunities for firms to engage with LP's and expand their partnership base. We welcome your inquiries on any of these insights and hope to advise our clients through strategic fundraising and operating plans.

We look forward to working with you.

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## Footnotes

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<sup>1</sup> Pitchbook & Bloomberg

<sup>2</sup> Africa news.com <https://www.africanews.com/2023/04/26/building-bridges-brics-alliance-paves-way-for-african-integration/#:~:text=Brics%20Summit&text=Made%20up%20of%20Brazil%2C%20Russia,the%20current%20major%20emerging%20powers.>

<sup>3</sup> World Bank

<sup>4</sup> Factset

<sup>5</sup> Factset

<sup>6</sup> World Federation of Exchanges & IMF

<sup>7</sup> World Federation of Exchanges

<sup>8</sup> <https://www.cnn.com/2023/04/24/economy/china-deflation-economy-intl-hnk/index.html> , IMF, and CFR <https://www.cfr.org/china-global-governance/>

<sup>9</sup> Bloomberg <https://www.bloomberg.com/news/articles/2022-01-27/wall-street-s-new-craze-is-splitting-china-from-emerging-markets>

<sup>10</sup> PitchBook

<sup>11</sup> PitchBook

<sup>12</sup> PitchBook

<sup>13</sup> UN <https://www.un.org/en/desa/india-overtake-china-world-most-populous-country-april-2023-united-nations-projects#:~:text=24%20April%202023%20%2D%20China%20will,the%20population%20of%20mainland%20China.>

<sup>14</sup> Bloomberg <https://www.bloomberg.com/news/articles/2023-04-13/apple-triples-india-iphone-output-to-7-billion-in-china-shift>

<sup>15</sup> Reuters <https://www.reuters.com/business/finance/d-e-shaw-expands-india-other-us-hedge-funds-ramp-up-hiring-2023-04-18/>

<sup>16</sup> Asian Development Outlook <https://www.adb.org/outlook>

<sup>17</sup> Jefferies Equity Research Strategy.

<sup>18</sup> Bloomberg <https://www.bloomberg.com/graphics/2023-middle-east-wealth-funds-with-more-money-than-uk-gdp-become-world-bankers/>

<sup>19</sup> S&P Global <https://www.spglobal.com/marketintelligence/en/mi/research-analysis/mena-regions-economic-growth-to-slow-after-strong-2022.html>

<sup>20</sup> Refinitiv [https://www.difc.ae/application/files/1116/8259/1061/DIFC\\_Refinitiv\\_Hedge\\_Funds\\_Report\\_April\\_2023-compressed.pdf](https://www.difc.ae/application/files/1116/8259/1061/DIFC_Refinitiv_Hedge_Funds_Report_April_2023-compressed.pdf)

<sup>21</sup> Refinitiv [https://www.difc.ae/application/files/1116/8259/1061/DIFC\\_Refinitiv\\_Hedge\\_Funds\\_Report\\_April\\_2023-compressed.pdf](https://www.difc.ae/application/files/1116/8259/1061/DIFC_Refinitiv_Hedge_Funds_Report_April_2023-compressed.pdf)

<sup>22</sup> HFR and CNBC <https://www.cnbc.com/2023/03/09/amid-global-downturn-the-finance-world-is-chasing-middle-eastern-money.html>

<sup>23</sup> Henley Private Wealth Migration Dashboard

<sup>24</sup> IMF

<sup>25</sup> United Nations Population Division

<sup>26</sup> Bloomberg <https://www.bloomberg.com/graphics/2023-middle-east-wealth-funds-with-more-money-than-uk-gdp-become-world-bankers/>

<sup>27</sup> Refinitiv [https://www.difc.ae/application/files/1116/8259/1061/DIFC\\_Refinitiv\\_Hedge\\_Funds\\_Report\\_April\\_2023-compressed.pdf](https://www.difc.ae/application/files/1116/8259/1061/DIFC_Refinitiv_Hedge_Funds_Report_April_2023-compressed.pdf)

<sup>28</sup> Sanabil Investments <https://www.sanabil.com/en/home>

<sup>29</sup> Bloomberg <https://www.bloomberg.com/graphics/2023-middle-east-wealth-funds-with-more-money-than-uk-gdp-become-world-bankers/>

and Bloomberg <https://www.bloomberg.com/news/articles/2023-05-01/credit-suisse-s-largest-backer-to-hold-0-5-of-ubs-after-merger>

<sup>30</sup> Atlantic Council.org <https://www.atlanticcouncil.org/blogs/menasource/many-european-soccer-teams-are-owned-by-gulf-states-but-why/>

<sup>31</sup> Rand National Security Research Division <https://www.rand.org/pubs/perspectives/PEA1149-1.html>

<sup>32</sup> CNBC <https://www.cnbc.com/2022/05/31/israel-signs-trade-deal-with-uae-its-biggest-with-any-arab-country.html>

<sup>33</sup> UAE Embassy <https://www.uae-embassy.org/discover-uae/foreign-policy/abraham-accords-warm-peace-transforming-middle-east>

<sup>34</sup> <https://www.bloomberg.com/news/articles/2023-02-13/world-s-riskiest-em-bonds-in-play-as-distressed-makes-a-comeback>

<sup>35</sup> <https://www.bloomberg.com/news/articles/2022-12-16/jpmorgan-says-buy-emerging-world-debt-as-growth-inflation-slow>

<sup>36</sup> IMF