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Investing in Emerging Markets

Dominic Bokor-Ingram, Senior Portfolio Manager of Fiera Capital's Emerging and Frontier Markets Strategies, recently spoke to Rich Mullen, CEO and Founder of Pallas Capital, and Pallas Capital Advisors Chief Investment Officer Garav Milnick, on how he thinks about geopolitics in the context of Emerging Markets investing with his over thirty years industry experience.

Dominic, let's dive into your background a little bit, before entering the investment industry and what attracted you to work and spend time in the emerging markets.

I guess you could say my emerging market journey began in 1978 when I visited Hungary for the first time as a 10 -year -old boy. My father's Hungarian and left Hungary in the 1956 uprising.

And by sheer coincidence, my financial career started in the city of London in 1989, which was the year the Berlin Wall fell. I was working in closed-end funds initially, and most closed-end funds invest in emerging markets Pretty soon I found myself in the middle of the start of massive change in Eastern Europe, both economically and socially. It also saw the opening up of a lot of stock markets across Russia, the former Soviet Union and Eastern Europe. Having a personal interest and understanding the context of the region, I became very quickly the Eastern European specialist at the firm.

And that was really my introduction to emerging markets, and I've never left. The first Eastern European market I invested in was Hungary in 1992, which was the first post-Eastern bloc country to open a stock market, closely followed by Russia in 1993. And I spent most of the 1990s investing in debt and equity markets across Eastern Europe.

This expanded in the 2000s into opportunities in Africa and then in the 2010 into the Middle East, which has been a real focus of investment for myself and my team over the last 13 years or so. We have subsequently built up substantial investments across the Gulf region.

So, my experience has really been at the sharper end, if you like, the more frontier end of emerging markets. And I've seen the cycles as they develop,

Dominic, with that rich history, background, going through geopolitical crises, macro crises over time, when you look at the world today in the context of rearmament occurring across the world, conflicts, Russia, Ukraine, Israel, Hamas, all the rising tensions that Rich spoke about. Does it feel like it's different this time, or is it like one of those periods we've witnessed in the past?

I believe it's probably different this time. And really for this reason, emerging market GDP as a percentage of global GDP is now pretty much approaching 50% and will go over 50%.

Not just that, but the unipolar dominance that we've had really since the end of the Cold War of the US, with Russia effectively disarmed and disabled after the fall of the Berlin War and the collapse of the Soviet Union, the US hasn't really had a global challenger. There hasn't been a clear sort of opposition globally to it. However, there are two countries now emerging that over the coming years might well create the bipolar world or tripolar world that we have not experienced for the last 40 years.

And by that, I mean China and India. Within that context and within this bi or tripolar world, I believe that there is going to continue to be a lot of jostling for position, a lot of jostling for power, and that historically has normally been done by proxy.

A lot of what we're seeing now is actually not direct conflict between previous or future superpowers, but actually a lot of proxy battles to try and establish dominance and ground rules. I suppose this is what is reflected in the Russia-Ukraine war, where you're seeing Russia trying to assert itself over NATO and other parts in Europe.

When you think about that conflict, how do you see this playing out? How do you see this bipolar world that you describe? As you think about U.S. and Russia specifically, how do you see the conflict playing out from that perspective?

Taking a non-political view, war is inflationary, and war with a country like Russia, which produces a huge amount of oil and gas and other minerals as well as products, is going to sustain inflation for as long as the war exists. I think ultimately the people will decide, and people normally decide elections by what's in their pocket or by economics.

So Dominic, as we start looking out, now I understand it's very difficult to put a timeline on various things, but as you look at the Russia -Ukraine or Middle East conflict, is it that we're waiting for binary outcomes with elections? Is it that there's a natural pathway where there'll be so much pressure internally in various countries, that you have to withdraw support or reduce the amount of aid you're giving?

I think in terms of Russia, Ukraine, you know, it's probably sometime next year that you start to see significant de-escalation.

I can see the Russia-Ukraine conflict being, I wouldn't say resolved, but substantially de-escalated and from an economic perspective, starting to be resolved next year.

I think with the Middle East it's much harder to predict because you're looking at the economic aspects, but also the existential threat that some countries in the region feel. And I think it's an existential threat that's probably felt both by the Iranian regime and by Israel generally.

And so, the backing down points, are much harder to predict, because you can't back down while you still feel there's some kind of existential threat.

I think the biggest implication for this is not in the Gulf region where these countries are going to continue to do extremely well. particularly in the face of your high commodity prices, which is what they have for sale. I think the biggest implication for global investors is that inflation is probably going to remain higher for longer than we think.

The largest short-term implication of what's happening in the Middle East is the rerouting of shipping around the Cape of Good Hope instead of through the Suez Canal. If you look at a map of how goods get from Asia to Europe and to the US, you're pretty much looking at double the shipping cost. Already some of the companies in Europe, such as retailers in Greece, who sell a lot of Chinese goods are already saying there's a real shortage of goods in Europe that emanate from China and Asia.

And again, that can only lead to inflation. I don't see the geopolitical aspects of what's going on in the Middle East playing out globally, but I do see the economic inflationary aspects playing out globally.

As we think about the investment landscape for a second. Is it important for us to be thinking about emerging markets? How should we figure that in our calculus, especially with all these conflicts, geopolitical risk at play? How should we think about that?

Well, I think the original reason for investing in emerging markets, back when emerging markets became kind of more fashionable in the late 1980s, was going and looking for growth opportunities that were higher than the growth you had in your own country.

And for us, that's always been the only reason to go and invest in emerging markets. So, I would look at emerging markets very much as an opportunity set and not an asset class. And within that opportunity set, it's basically an opportunity set that is any country in the world that is not developed.

With that in mind, there are going to be countries that are going through very positive reforms, very positive changes, creating high levels of economic growth. And there are going to be countries going through negative reforms and sometimes spiraling into failed states even.

And if you look at the landscape and you compare emerging markets 20 years ago to what they are today, you would have made a lot of money investing in places like China and India and even the Middle East. You would have lost a lot of money investing in places like Russia, South Africa, Turkey and Argentina.

So, I think what the multipolar world does is make it much less of a binary decision whether to invest in emerging markets or not, but splits the world into places where you want to be and places where you don't.

It requires a much more active approach than it has done in the past. Now, I would say what is happening in places like the Middle East, in places like India and parts of Eastern Europe, is that you are seeing huge growth that you won't find in developed markets and many ways of accessing that growth through equity markets and even sometimes debt markets.

I wouldn't propose acting on an asset class basis. I would propose acting on an opportunity type of business.

So Dominic, based on your 30-year history being in emerging markets, when you look at long-term sustained performance, economic growth, stock market performance, what are some of the factors you look at? What is it that drives your decision and says, okay, this is why, a China or India or Saudi is attractive. And then, Russia and Argentina are not attractive. So what's the long-term dynamics, political leadership, economic will? What is driving that?

In my opinion, the single most important factor has turned out to be leadership. I give the example of Iran and Saudi Arabia, which I was investing in Iran back in 2013, and thought it was one of the most interesting places I'd ever been to invest. It had quite a wealthy population and very high levels of education.

It was very advanced in its communications, its technology, as manufacturing, had fantastic quality management because of the high levels of education, abundant resources and very good agriculture.

It should be the same as Germany as a comparison in terms of wealth, GDP per capita development. And at that time it was about a third of the level of Germany.

If you went to Saudi Arabia at the time, it was a very closed society. If you just take women's rights in Iran, a lot of companies had women as directors, CFOs, and CEOs. In Saudi Arabia, women weren't really in the workforce and had all the restrictions that we know about placed on them. If you'd asked me 10 years ago, where would you think these two countries would be in 2024?

I would have said Iran should be much closer to Germany and Saudi probably would have been in the same place it was. The appointment of Mohammed bin Salman in Saudi Arabia as its leader in 2013 changed everything.

He was the first king appointed in Saudi Arabia or elected in Saudi Arabia under the age of 80 years old in the nation's history. He had a 50 -year vision, and he said about implementing that vision to change culturally, socially, economically, every level of the economy. And so you have a country in Saudi Arabia now, which is much more likely to reach German levels of GDP, or even US levels of GDP per capita, than Iran. It is probably down 40% over that 10-year period, while Saudi is up 40% in terms of GDP.

And that simply is down to leadership. You can look at many other examples around the world. One hundred years ago, Argentina was the sixth wealthiest country in the world in terms of GDP. Today, it's been a failed state four times in the last 20 years.

So, I think the single most important factor is leadership, as having leadership will then build institutions, and ultimately to attract long-term capital. This is what you need to develop power and infrastructure to urbanize and to grow an economy, as it all requires long -term investment.

Long -term investment will only come with the institutional infrastructure in terms of the banking system, the judicial system, and the planning system. All of these other factors around deploying long -term capital enable economies to effectively urbanize and develop.

And that is what creates wealth. So, it needs leadership. It needs that leadership to implement the right structures. And then it's fairly straightforward and predictable what will happen under those conditions.

My last question for you, Dominic, as you look across the emerging market landscape, what countries look attractive to you and then should investors access this through equity, through debt? What's your perspective on that?

To start with the equity debt question, I've looked at emerging market debt for a long time and considered it in many instances to be equity with no upside.

And I think in a large number of instances, that is probably true. The reason that I would put my own capital into an emerging market situation is for the upside and for the growth, rather than to get paid back.

If I look today where in the world has this kind of long-term vision and leadership, I would pick out some specific examples.

India being the biggest of the large emerging markets. With Korea not very far behind. understanding that a high equity market valuation is advantageous to drive innovation and particularly investment in innovation.

Among some of the smaller countries, I think Vietnam has probably the best long-term revaluation and growth prospects of any country in emerging markets. It's following the same model as China followed, but it's about 25 years behind for historic political reasons. I see the Middle East developing and changing in the same way as Eastern Europe did after the Berlin wall fell in 1989, in terms of the level of economic change but also in terms of social and cultural change.

The economic development of parts of eastern Europe, particularly countries like Poland and Hungary. They are going to at some point in the next 20, 30 years, overtake some of the more well -known Western European economies in terms of wealth, because of domestic policies employed.

We think it's probably a bit far off for most of Africa in terms of the ability to attract long -term capital and Latin America seems to be mired in one political crisis after another caused mainly by the strength of the trade unions. At some point, that will be broken but we don't think it's interesting right now.

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