FRANKLIN TEMPLETON

Investment Team Update
August 31, 2021

Emerging Markets Insights

A Tale of Two Halves in Emerging Markets in August

Three Things We're Thinking About Today

1. Our view is that the increased **regulatory scrutiny in China's internet sector** is focused on creating conditions conducive to long-term sustainable growth for all stakeholders—rather than curbing the development of the technology sector. Chinese technology companies contribute to a significant proportion of economic growth and employment in the economy and play a pivotal role in the Chinese government's technological goals. Therefore, our view is given the government's plan to use innovation as a driver of gross domestic product (GDP) growth and productivity gains in the long term, the intention is not to curtail innovation and innovative businesses. Rather, the objective is to avoid monopolistic positions that could have negative effects without the appropriate controls. China's ambitious roadmap includes tapping into a formidable resource not every other country has—a vast population that can drive demand, and a history filled with rapid adoption of modern technology.

2. We believe that **economic growth drivers in China** will largely stem from domestic consumption, innovation and technology—consistent with areas highlighted in the previous Five-Year Plan—and a commitment to the environment, with targets for the country to reach peak carbon emissions by 2030 and achieve carbon neutrality by 2060. The plan's manufacturing upgrade will also prompt companies to create supply chain self-sufficiency as China moves up the value chain, as a result of accelerated adoption of local technology and digitalization. Hence, we believe that there will be beneficiaries of China's effort to re-balance wealth distribution as the other aspects of the common dual circulation policy that focuses on carbon neutrality, technology localization and consumer premiumization (made possible with rising incomes) could create attractive investment opportunities.

3. **Inflation** has elevated around the world as supply bottlenecks, shipping disruptions and recovering demand have been driving up prices. Higher commodity prices and base effects have also been lifting headline inflation. While we expect this situation to be transitory and look for inflation to moderate in 2022, heightened prices and post lockdown booms have forced some emerging market (EM) central banks to act. South Korea, Brazil, Mexico, Russia and parts of Central and Eastern Europe have already started tightening, but others across the world are willing to wait. We believe that investors should not be too worried about the upward move in inflation across much of EMs, but rather view it as an expected part of economic normalization post the COVID-19 crisis.

Market Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
Argentina (30.5%)	Pakistan (-4.9%)
Thailand (11.6%)	Brazil (-2.2%)
Philippines (11.5%)	Korea (-1.6%)

Sector Performance (MSCI EM Index, USD)
Cumulative Return

Best	Worst
Utilities (9.1%)	Consumer Discretionary (-1.8%)
Financials (6.4%)	Healthcare (-0.8%)
Energy (6.3%)	Materials (-0.6%)

Currency Performance (MSCI EM Index, USD)
% Change

Best	Worst
Colombia (2.7%)	Pakistan (-2.3%)
Hungary (1.98%)	Chile (-2.1%)
Thailand (1.97%)	Argentina (-1.1%)

Source: FactSet, one-month period ending 08/31/21.

Outlook

Outbreaks triggered by new COVID-19 variants and a slow vaccination pace could result in new lockdowns and hinder economic normalization in some EMs in the short term. However, we are seeing countries accelerate vaccination efforts and vaccine manufacturers increasing capacity, leading us to believe that most economies are on the path to economic normalization.

Expectations of US Federal Reserve (Fed) tapering have also heightened market volatility. Higher US interest rates could also trigger a strengthening of the US dollar–this would be potentially negative for EMs with macro vulnerabilities, though there are much fewer significant emerging economies in this situation today. Indeed, a pickup in US interest rates has not necessarily been negative for EM equities in the past. If we look at examples of when US Treasury yields moved up by more than 25 basis points (0.25%) in a month since 2007, the average returns for EM equities during these episodes have been higher than the historical average, as rising rates are generally associated with a better growth outlook rather than concerns over inflation, which should broadly support equities.

While unexpected policy changes may create uncertainty in China, fueling volatility and increasing risk premia, we believe such deviations should be temporary, as stock prices are primarily driven by a company's ability to sustain profitability through earnings. In general, while uncertainty and volatility are inherent to investing in China, we believe Chinese equities can offer interesting opportunities for long-term investors, including compelling themes that can benefit from innovation, technology and rising consumption. China is a challenging market to navigate, but patient, selective investors who are willing to look beyond short-term noise could find opportunities that outlive the headlines.

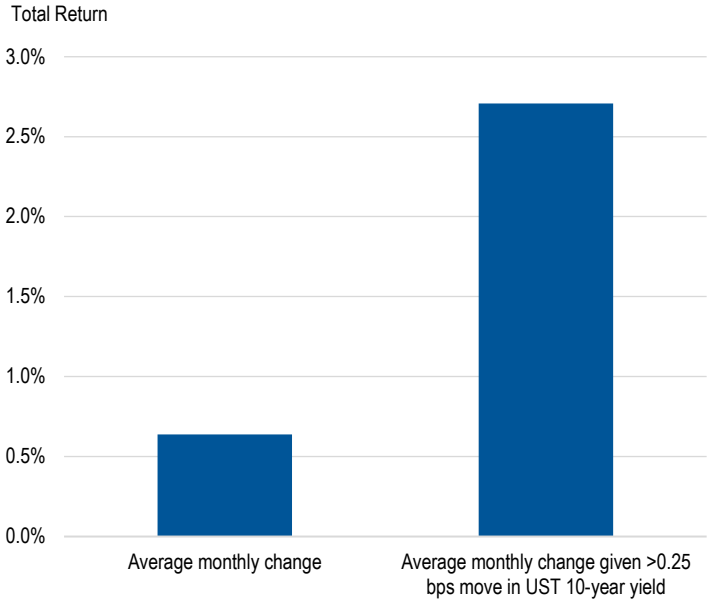
Overall, we believe that EMs are still likely to remain resilient in the face of these challenges, supported by the many factors we have discussed in the past about the strength of the EM opportunity set.

Emerging Markets Key Trends and Developments

Stocks worldwide rose in August. The Fed's measured tone on monetary stimulus tapering offered relief to investors concerned about the impact of COVID-19's resurgence on global economic growth. EM equities slightly outpaced their developed market peers in US-dollar terms, thanks to a broad appreciation in EM currencies. The MSCI Emerging Markets Index rose 2.6% over the month, while the MSCI World Index returned 2.5%, both in US dollars.[1]

Emerging Markets Record Higher Returns During Periods of Increased US Treasury Yields

MSCI Emerging Markets Monthly Total Returns
January 2007 - August 2021



Sources: US Department of Treasury, MSCI, Macrobond. Indexes are unmanaged, and one cannot invest directly in an index. They do not reflect any fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future performance.**

The Most Important Moves in Emerging Markets in August 2021

- Emerging Asian equities advanced in August. Southeast Asia staged a strong market rebound as COVID-19 restrictions began to ease in countries such as Thailand, the Philippines and Indonesia. Indian stocks rallied amid encouraging economic momentum and continued policy support. China's market closed nearly flat to trail the region. New COVID-19 outbreaks, weaker-than-expected economic data and fears of widening regulatory scrutiny across the internet and other industries weighed on investor sentiment. South Korea's index fell as its technology heavyweights declined. The Bank of Korea raised its key interest rate, becoming the first major Asian central bank to do so since the start of the pandemic.
- Latin America lagged its EM counterparts in August, largely due to a decline in the Brazilian market. Another delay in the vote on the tax reform bill, fiscal and interest rate concerns, and a decline in commodity prices weighed on sentiment in Brazilian equities. The Brazilian central bank raised its key benchmark rate by 100 basis points (1.0%) in August, and expects a similar increase at its next meeting, amid expectations of higher inflation. Uncertainty in the new government's political agenda continued to hold back returns in Peru. In Mexico, a continued recovery in domestic demand saw activity reaching close to its pre-pandemic levels.

- The Europe, Middle East and Africa region was the top-performing EM region during the month, supported by positive performances in all the markets in the benchmark. Hungary, Turkey and the Czech Republic led the outperformers, while South Africa, Russia and Qatar lagged their regional peers. Sentiment in Russia was impacted by a decline in oil prices despite preliminary reports of better than expected second-quarter GDP growth numbers. The relative underperformance in South Africa was largely driven by a key constituent, which bore the brunt of tightening regulations in China's internet sector. Several materials stocks were also impacted by a correction in metal prices.

1. Source: MSCI. The MSCI Emerging Markets Index captures large- and mid-cap representation across 24 emerging-market countries. The MSCI World Index captures large- and mid-cap performance across 23 developed markets. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or guarantee of future results.** MSCI makes no warranties and shall have no liability with respect to any MSCI data reproduced herein. No further redistribution or use is permitted. This report is not prepared or endorsed by MSCI. Important data provider notices and terms available at www.franklintempletondatasources.com.

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- **16 years on average of industry experience**
- **8 years on average with Franklin Templeton**

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