A New Moment for Emerging Markets

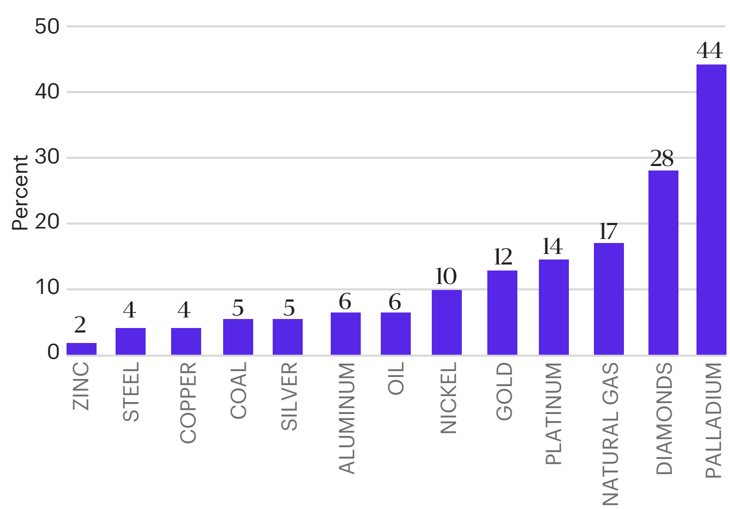
By: Ann Miletti, Head of Active Equity
Elaine Tse, Portfolio Manager, Total Emerging Markets
Derrick Irwin, CFA, Portfolio Manager, Intrinsic Emerging Markets

In the wake of the Russian invasion of Ukraine, the drawdown in emerging market equities took on an air of capitulation, bordering on a vote of no confidence in their long-term prospects.

The negativity mirrors sentiments that are typically held at the top of market bubbles when extreme market action decouples prices far from intrinsic values. A lot of the bad news has clearly been discounted, yet we are left with the simple question: Is it still too early to invest in emerging markets? In this note, we gather insights from Allspring's Intrinsic Emerging Markets and Total Emerging Markets teams to make the bull case for active investment in this asset class today.

The Russian invasion of Ukraine certainly added to global inflationary pressures that were already gathering steam in the months leading up to the war. Despite Russia's modest weighting in the flagship MSCI Emerging Market Index (about 3% prior to the invasion and now less), Russia is a key player in the world of commodities—both mineral and agricultural. Russia accounted for about 12% of global oil supply, 17% of natural gas, and 6% of aluminum and is a core supplier of platinum group metals that form the base inputs of countless industrial supply chains. The unceremonious severing of existing trade and financing relationships with Western economies through coordinated sanctions has darkened the global growth outlook and increased the risks of stagflation.

RUSSIA'S SHARE OF GLOBAL COMMODITIES PRODUCTION IN 2020



Source: J.P. Morgan; March 18, 2022

A STRATEGIC BLUNDER?

China's standing as a natural beneficiary in growing bilateral trade with Russia was without question part of the calculus behind the "no limits" partnership showcased during the Olympic opening ceremony. However, the alliance may be approaching limits after all, merely weeks into Russia's botched military campaign, which has laid bare the weakness of Russia's conventional military forces and its financial position for the world to see. It no doubt underestimated Ukraine's resistance and resolve for independence. More broadly, both Russia and China were likely surprised at the emergence of Western resolve—particularly in Europe, where support for NATO had been eroding for years. Freedom, autonomy, and memories of the atrocities of World War II have allowed the West to coalesce on a moral high ground, fueling political resolve to confront the situation rather than fold. China, which hopes to avoid Russia's pariah status, is maintaining some diplomatic distance and maneuverability to pursue its longer-term plans of outward engagement. With the ever-present Taiwan question in the background, it is our view that, at least in the near term, China's appetite for taking the island by force has waned. In short, the West has emerged more united than many anticipated, and this could present conditions for an off-ramp that may not yet be fully appreciated by markets.

STRONGER THIS TIME?

In prior crises, global capital has fled emerging economies for perceived safety offshore. This time, however, this playbook may be showing its age. COVID-19 disruptions had already brought inflationary pressures to emerging economies, causing several to defend their currencies ahead of these latest developments. Last year, for example, Brazil raised rates 725 basis points (bps; 100 bps equal 1.00%) and Chile raised rates by 350 bps. While rates remain generally lower in Asia, central banks are still ahead in the rates cycle—for example, the Bank of Korea raised rates by 50 bps in 2021. These actions have helped stem the outflow of capital. More broadly, several emerging market countries have sustained positive real rates (nominal rates are higher than inflation) while real rates in developed markets remain deeply negative, even after recent central bank actions. Moreover, the structural arguments for emerging markets that have been touted for years—for example, growing middle-class populations and positive current accounts—remain intact. Their steady growth over the past decade has made today's developing economies more integrated and become a much greater share of global capital markets by value than they have in the past, making the outward movement of capital structurally more difficult. Taken together, the strength of many countries outside of the direct melee of Eastern Europe may offer a more diverse and stable foundation for patient capital than it has during past crises.

GROWING DIVERSITY, NEW ORDER

Most professional investors at the helms of asset managers have grown up during a period of ever-greater integration and globalization under institutions created and supported by Western powers. The founding of the World Trade Organization in 1995 could mark the beginning of this rare unipolar moment in history. If we consider the pandemic, the chaotic U.S. withdrawal from Afghanistan, and the Russian invasion of Ukraine all as stages in an unfolding breakdown of this existing world order, it is likely that a multipolar world—like the one that characterized the post-WWII period, but with more independent nodes—would arise to fill the vacuum. The aggressive posturing of Russia, Iran, North Korea, and China is defining an emerging block in direct opposition to the West, with several undecideds in between. Is this necessarily worse for emerging markets than developed markets?

Not necessarily. In this scenario, many of the holdouts would be courted by both sides, sitting in the proverbial catbird seat, enjoying new influence and the foreign investment that accompanies it. Commodities are fungible, which implies they will ultimately flow to the high bidders but, perhaps, through different channels. High prices encourage new investment. For example, increased agricultural production from Latin America could help fill the void, and there are countless other substitutions that might be enacted. Geopolitically, the decoupling of existing alliances could lead to a recoupling in ways that are only beginning to be understood by markets. We think this presents a golden opportunity for forward-looking investors who do not extrapolate the anomalous unipolar moment in perpetuity.

THE OPPORTUNITY

Have markets overshot? It's hard to say. Markets are at times dominated by systemic shocks, and this one is far from played out. Yet, like Allspring's other fundamental equity teams, the Intrinsic Emerging Markets and Total Emerging Markets teams don't invest in countries or themes. They do invest in companies that are supported by quality fundamentals that can help them withstand systemic shocks in the short term and, importantly, that can improve the competitive position of their products and services during such periods. Company fundamentals ultimately dictate the fate and economic value of an investment—there will be winners and losers. We believe the early stages of this dislocation are presenting fertile ground to reposition portfolios for our investors' long-term success.

This information is not a marketing communication and is provided for informational purposes only. For Professional/Qualified clients. Recipients who do not wish to be treated as Professional should notify their Allspring contact immediately.

Allspring Global Investments™ ["Allspring"] is the trade name for the asset management firms of Allspring Global Investments Holdings, LLC, a holding company indirectly owned by certain private funds of GTCR LLC and Reverence Capital Partners, L.P. These firms include, but are not limited to, Allspring Global Investments (UK) Limited ["Allspring UK"] an investment management company, authorised and regulated by the UK Financial Conduct Authority (FCA), and Allspring Global Investments Luxembourg S.A ["Allspring Luxembourg"], authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF). Allspring Luxembourg has branches in Frankfurt and Paris and is allowed to provide services on a cross-border basis in the EEA. Allspring UK does not provide services to retail clients, the Financial Services and Markets Act 2000 (FSMA) rules for retail clients will not apply and the United Kingdom Financial Services Compensation Scheme is not available.

THIS MATERIAL DOES NOT CONSTITUTE AN OFFER OR SOLICITATION IN ANY JURISDICTION.

Past performance is not a guarantee or reliable indicator of future results. All investments contain risk. Unless otherwise stated, Allspring is the source of all data (which is current or as of the date stated); content is provided for informational purposes only with no representation regarding its adequacy, accuracy or completeness; views, opinions, assumptions or estimates are not necessarily that of Allspring or Allspring Global Investments Holdings, LLC and are subject to change without notice; information does not contain investment advice, an investment recommendation or investment research, as defined under local regulations.

Distribution in the United States: Allspring Global Investments™ is the trade name for the asset management firms of Allspring Global Investments Holdings, LLC, a holding company indirectly owned by certain private funds of GTCR LLC and Reverence Capital Partners, L.P. These companies include but are not limited to Allspring Global Investments, LLC, and Allspring Funds Management, LLC. Certain products managed by Allspring entities are distributed by Allspring Funds Distributor, LLC (a limited-purpose broker-dealer and Member FINRA/SIPC). Associated with Allspring is Galliard Capital Management, LLC (an investment advisor that is not part of the Allspring trade name/GIPS firm).

Distribution in the United Kingdom (UK), European Economic Area (EEA) and Switzerland: Allspring Global Investments™ (Allspring) is the trade name for certain investment management companies owned by Allspring Global Investments Holdings, LLC, including, but not limited to, Allspring Global Investments (UK) Limited (Allspring UK), an investment management company authorised and regulated by the UK Financial Conduct Authority (FCA), and Allspring Global Investments Luxembourg S.A. (Allspring Luxembourg), authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF). Allspring Luxembourg has branches in Frankfurt and Paris and is allowed to provide services on a cross-border basis in the EEA. This material has been approved for distribution in the UK by Allspring UK for the purposes of Section 21 of the Financial Services and Markets Act 2000 (FSMA). Allspring UK does not provide services to retail clients, the FSMA rules for retail clients will not apply and the United Kingdom Financial Services Compensation Scheme is not available. Unless otherwise stated, information does not contain investment advice, an investment recommendation or investment research as defined under UK FCA regulations or the Markets in Financial Instruments Directive (Directive 2014/65/EU (MiFID II) and therefore does not comply with the requirements for the provision of such services. For professional investors only. Recipients who do not wish to be treated as professional should notify their Allspring contact immediately.

Distribution in the United Arab Emirates (excluding Dubai International Financial Centre and Abu Dhabi Global Market): Allspring Global Investments™ (Allspring) is the trade name for certain investment management companies owned by Allspring Global Investments Holdings, LLC, including, but not limited to, Allspring Global Investments (UK) Limited (Allspring UK), an investment management company authorised and regulated by the UK Financial Conduct Authority (FCA); Allspring Global Investments Luxembourg S.A. (Allspring Luxembourg), authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF); and Allspring Global Investments, LLC. This material is intended for professional clients (defined by DFSA). This material, and the information contained herein, does not (intend to) constitute a public offer in the United Arab Emirates (UAE) and should not be construed as such. It is offered to a limited number of exempt investors in the UAE who fall under one of the following categories of non-natural qualified investors: 1. an investor that is able to manage its investments on its own, namely the federal government, local governments, government entities and authorities or companies wholly owned by any such entities; international entities and organisations; or a person licensed to carry out a commercial activity in the UAE, provided that investment is one of the objects of such person, or 2. an investor who is represented by an investment manager licensed by the Securities and Commodities Authority (SCA), each a non-natural qualified investor. The materials have not been approved by or licensed or registered with the UAE Central Bank, the SCA, the DFSA, the Financial Services Regulatory Authority or any other relevant licensing authorities or governmental agencies in the UAE (the authorities). The authorities assume no liability for any investment that the named addressee makes as a non-natural qualified investor.

Distribution in Australia: Allspring Global Investments, LLC, is exempt from the requirements to hold an Australian financial services license in respect of the financial services it provides to wholesale clients in Australia. Allspring Global Investments is regulated under US laws, which differ from Australian laws. Any offer or documentation provided to Australian recipients by Allspring Global Investments in the course of providing financial services will be prepared in accordance with the laws of the United States and not Australian laws.

Distribution in New Zealand: this material and the information contained in or accompanying this material are not, and are under no circumstances to be construed as, an offer of financial products for issue requiring disclosure to an investor under Part 3 of the Financial Markets Conduct Act 2013 (N.Z.) (the Financial Markets Conduct Act (N.Z.)). This material and the information contained in or accompanying this material have not been registered, filed with or approved by any New Zealand regulatory authority or under or in accordance with the Financial Markets Conduct Act (N.Z.). This material and the information contained in or accompanying this material is not a disclosure document under New Zealand law and does not contain all the information that a disclosure document is required to contain under New Zealand law. Any offer or sale of any interests described in these materials in New Zealand will be made only: (a) to a person who is an "investment business" within the meaning of clause 37 of Schedule 1 of the Financial Markets Conduct Act (N.Z.), (b) to a person who meets the investment activity criteria specified in clause 38 of Schedule 1 of the Financial Markets Conduct Act (N.Z.), (c) to a person who is "large" within the meaning of clause 39 of Schedule 1 of the Financial Markets Conduct Act (N.Z.), (d) to a person who is a "government agency" within the meaning of clause 40 of Schedule 1 of the Financial Markets Conduct Act (N.Z.), (e) to a person who is an "eligible investor" within the meaning of clause 41 of Schedule 1 of the Financial Markets Conduct Act (N.Z) or (f) in other circumstances where there is no contravention of the Financial Markets Conduct Act (N.Z.) (or any statutory modification or re-enactment of, or statutory substitution for, the Financial Markets Conduct Act (N.Z.)). In subscribing for interests, each investor represents and agrees that it is not acquiring those interests with a view to dealing with them (or any of them) other than where an exclusion under Part 1 of Schedule 1 of the Financial Markets Conduct Act (N.Z.) applies to such dealing and, accordingly: (a) it has not offered or sold, and will not offer or sell, directly or indirectly, any interests and (b) it has not distributed and will not distribute, directly or indirectly, any offering materials or advertisement in relation to any offer of interests, in each case in New Zealand within 12 months after the issue of interests to that investor other than to persons who meet the criteria set out in (a) to (d) above.

Distribution in South Korea: this document is distributed in the Republic of Korea by Allspring Global Investments, LLC, which is registered with the Financial Services Commission pursuant to the Financial Investment Services and Capital Markets Act (the Act) to conduct investment advisory and discretionary investment business with qualified professional investors (as defined in the Act). This document is not intended for, and should not be relied on by, any person other than qualified professional investors.

Distribution in Japan: this material and the information contained herein does not constitute and is not intended to constitute investment advice or an offer of securities and accordingly should not be construed as such. Any products or services referenced in this material may not be licensed or registered in all jurisdictions and, unless otherwise indicated, no regulator or government authority has reviewed this material or the merits of the products and services referenced herein. This material and the information contained herein have been made available in accordance with the restrictions and/or limitations implemented by any applicable laws and regulations. This material is directed at and intended for "professional" or "institutional" investors (as such term is defined under the laws of each applicable jurisdiction). This material is provided on a confidential basis for informational purposes only and may not be reproduced in any form. Allspring does not provide tax, legal or accounting advice, and this material does not take an investor's personal investment objectives or financial situation into account. Before acting on any information in this material, prospective investors should inform themselves of and observe all applicable laws, rules and regulations of any relevant jurisdictions and obtain independent advice if required. This material is for the use of the named addressee only and should not be given, forwarded or shown to any other person (other than employees, agents or consultants in connection with the addressee's consideration thereof).

Distribution in Canada: Allspring Global Investments™ (Allspring) is not registered as an investment advisor in any of the Canadian provinces, is only authorised to provide investment advisory services in Canada pursuant to an exemption available to foreign investment advisors under Canada's National Instrument 31-103 (NI 31-103) and can provide such services only to "permitted clients" as defined under NI 31-103. Allspring is registered as an investment advisor with the United States Securities & Exchange Commission. Its head office is located at 525 Market Street, 12th Floor, San Francisco, California, 94105, and, thus, substantially all of its assets are situated outside of Canada. As a result, there may be difficulty enforcing legal rights against Allspring because of the above, and investors are directed to Blakes Vancouver Services, Inc., Allspring's agent for service of process, in the event of any disputes at the following address, phone number and email address: Blakes Vancouver Services, Inc., 595 Burrard Street, Suite 2600, Three Bentall Centre, Vancouver, BC, V7X 1L3; phone: +604-631-3300; email: lisa.marchese@blakes.com.

FOR PROFESSIONAL/QUALIFIED INVESTORS USE ONLY.

US: PAR-0322-00586
EMEA: 0322-00627
APAC: PAR-0322-00587
CANADA: PAR-0322-00588