For emerging-market equity investors, the COVID-19 crisis helps to define a critical juncture. Our emerging markets equity team believes that some companies and geographies are showing deep vulnerabilities; others remarkable resilience. Focusing on the latter is the sustainable investment path ahead.

First in, first out: North Asian equities exhibit post-pandemic strength

From a bottom-up standpoint, many of the structural themes that we see playing out across emerging markets have been reinforced—and in some cases accelerated—by the pandemic. The amplification of these trends can be seen in two key areas across emerging markets. First, while a range of companies has struggled in the face of a global health crisis and related economic challenges, a select group of firms within certain industries have shown remarkable resilience and even managed to accelerate their growth. A number of these standout companies are found today in industries that were already experiencing strong growth before the coronavirus outbreak, such as e-commerce, electronic payments, cloud computing services, data centres, online education, and online healthcare diagnostics.

The second distinction is geographic. Relative to other emerging markets, China, South Korea, and Taiwan have contained the crisis decisively, from a public health, economic, and policy perspective, creating a significant range of investment opportunities.

Pandemic-driven technological change

COVID-19 has highlighted the long-term potential for select companies that have been able to tap into structural growth themes and possess skilled management teams as well as sustainable business models. While the pandemic presents operational challenges, today's work-and-shop-from-home environment has served as a tailwind, accelerating growth in commerce that can be conducted online and/or remotely. Think of electronic payments instead of cash, and virtual business meetings, medical appointments, and college classes rather than in-person interactions. These shifts have been made possible by technological advances and the proliferation of data to leverage off them.

The companies at the forefront of these changes are generally well ahead of their peers in integrating technology into their businesses, resulting in accelerating market share gains and sustainable growth. This technological transformation isn't just a US or developed-market phenomenon; many leading companies are emerging-market firms with increasingly global reach.

From an investment perspective, these trends present multi-tiered opportunities across emerging markets. For example, opportunities stemming from the rapid embrace of e-commerce in China can be applied to other emerging markets where e-commerce penetration is lower, creating a potentially long runway for growth and powerful network effects associated with well-designed business models. The challenge for investors is to identify such unrealized potential and target the companies best positioned to exploit these opportunities profitably.

An uneven recovery across emerging markets

After COVID-19-related concerns drove global equities to recent lows in March, a recovery began to take shape as the pandemic came under varying degrees of containment in many regions and initial signs of economic stabilization emerged. In our view, the rise in equity valuations triggered by the recent rally made it increasingly important to focus security selection on the businesses and countries that we believe appear to be in the best long-term positions to manage through today's economic constraints.

The importance of a targeted, selective investment approach is highlighted by the level of uncertainty caused by the pandemic and the changing market environment. Our favourable view of select emerging markets **in north Asia** reflects an assessment of their resilience during the current crisis and their relative strength based on their superior cost of capital. In this environment, we favour emerging markets where we have strong visibility into factors such as structural growth, liquidity, and currency depreciation risks; at the company level, we have increased our focus on firms where we have visibility relating to trends of revenue, free cash flow, and returns on invested capital.

China's unique position

At the country level, China—and other north Asian markets, to a lesser extent—benefit from having been the first to encounter COVID-19 and to apply drastic lockdown measures, in addition to being the first to progress toward containing the outbreak. These countries and territories have enjoyed a further tailwind from the powerful and sustainable response of their central banks and governments relative to some other emerging markets. China, for example, stands out in that it maintains a degree of control over its economic outcomes that is perhaps rivalled only by the United States.

In our view, this power is a product not only of the government's tight grip on the economy but of China's large, skilled labour force, its high savings rate to fund domestic investments, and its ecosystem for domestic capital formation. These strengths give China the ability to launch economic stimulus programs in the face of a crisis like the current pandemic. Just as the US Federal Reserve has recently been able to pursue interest-rate cuts and balance sheet expansion without much impact on the dollar's value in currency markets,[1] the People's Bank of China has employed monetary measures without significantly depreciating the yuan.[2]

In our view, while policymakers across emerging markets have generally sought to maintain accommodative stances, only a few countries such as China may have the capacity to apply necessary monetary and fiscal tools to fuel sustainable recoveries amid heightened uncertainty. Many other emerging markets—particularly in Latin America—are burdened by constrained fiscal resources as well as inadequate public health provisions, leading to closed borders and lockdown measures that may be late compared with those across much of Asia.

Navigating an uneven recovery

Across emerging-market equities, we see varying and potentially volatile speeds of growth resurgence and recession through at least the rest of this year. As investors, we're monitoring the situation carefully and seek to respond accordingly—both to weather the volatility that we see as an inevitable by-product of economic disruption and to gain exposure to those companies that we believe present resilient growth opportunities. We continue to find many of these opportunities in industries that are at the forefront of today's structural growth trends and are in the relatively strong emerging markets concentrated in north Asia.

[1] "The world loves the US dollar. Trump and the pandemic could change that," CNN, 16 July 2020.

[2] "China's June forex reserves rise less than expected on buoyant yuan," Reuters, 7 July 2020.

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