Emerging Markets Election Update

Local Views

June 24, 2024

INTRODUCTION

At the start of the year, investors heralded 2024 as the year where politics would be in the spotlight. With over 40% of the world's population heading to the polls, we have kept a close eye on political trends and their impact on equity investments. These events have important consequences for reforms, fiscal trajectories, global supply chains and geopolitics, creating volatility along the way. Within emerging markets, we have already seen key elections unfold in **Taiwan**, **India**, **Mexico**, and **South Africa** in the first 6 months of the year. We believe that local specialists on the ground are best placed to understand the nuances of recent political events. We asked our local partners in each of these geographies to share their perspectives on the elections and insights on their repercussions for equity investors.

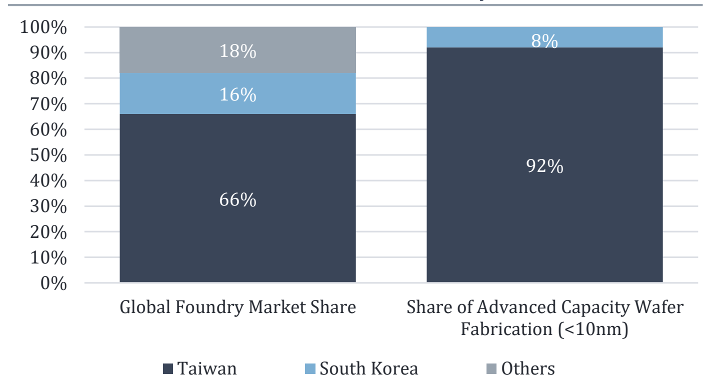
TAIWAN: LOCAL PERSPECTIVES FROM OUR TAIPEI BASED PORTFOLIO MANAGER

On January 13, 2024, Taiwan held elections for both its presidency and legislature. The election was closely watched by the world for its repercussions on geopolitics and the looming tension across the Taiwan Strait with China. At the polls, voters were largely tasked with choosing between the current ruling party, the Democratic Progressive Party (DPP) and one of the two opposition parties, Kuomintang Party (KMT) and Taiwan People's Party (TPP). The DPP is most known for its determination to maintain Taiwan's independence and had Lai Ching-te as its presidential candidate. Meanwhile the KMT, the key opposition party led by Hou Yu-ih, has long favored a closer relationship with China's central government. This year, a third party, the TPP, joined the electoral race as a third alternative with Ko Wen-je as its presidential candidate and a platform that also favored engagement with China.

The election in Taiwan concluded with the victory of Lai Ching-te from ruling DPP, securing 40% of the vote. Though the DPP secured a third consecutive term for the party, it was also the lowest vote share since 2000 and resulted in a loss of majority in the legislative Yuan (Taiwan's Parliament). While Beijing expressed disappointment with the outcome, the market response was fairly muted as the DPP had indicated an intention to largely maintain the current state of cross-strait relations.

2024 Upward Climb of the MSCI Taiwan Index

Taiwan: Leader in the Semiconductor Industry



Source: Bloomberg as of June 20, 2024 and Semiconductor Industry Association and Grand Alliance Asset Management as of 2019. Graph is presented for illustrative purposes only and should not be relied on to make an investment decision.

Despite the political significance of the election, the event in itself had minimal impact on our overall outlook for the Taiwanese economy. The new administration has reaffirmed commitments to economic growth, technological advancement, and international trade partnerships. These policies are designed to foster a stable economic environment. Today the key driver of growth in both the Taiwanese economy and equity market is Artificial Intelligence (AI), which is still in its early innings. Taiwan is widely recognized

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as the AI's global supply-chain epicenter and technology's development has anchored its systemic importance globally. Jensen Huang, CEO of NVIDIA, emphasized Taiwan's critical role in the AI revolution during his keynote at Computex 2024, stating, "Taiwan is the birthplace of NVIDIA and the epicenter of AI innovation". His remarks underscore the island's significance in the global AI supply chain and its capacity to drive technological advancements. Additionally, we think US-China tensions (e.g. restricting high-end semi-related exports to China) and geopolitical headwinds have helped to further strengthen Taiwan's AI's competitive moat, from upstream (e.g., semiconductors) to downstream components (e.g., original design manufacturing - ODMs). The increased support for these industries is evident in many firms' significant order book growth from the entire AI/tech industry. This creates more opportunities and incentives for Taiwan to innovate and differentiate in the AI space.

From our perspective as investors, the election implications in equity markets have proved to be minor. In fact, MSCI Taiwan has climbed +15.7% in 2024 through May 31. Foreign inflows over 2024 have also been strong, reflecting overall confidence in the market despite potential concerns around geopolitics. Key sectors, including technology (e.g. AI, semi/hardware) and consumer export driven industries (e.g. e-bikes, original equipment manufacturer textiles and ready-to-wear apparel), continue to perform well, driven by robust global demand and Taiwan's leadership positioning in these industries. Even industries which tend to be more sensitive to geopolitical headlines have seen company fundamentals overshadowing election headlines. For example, the airline industry, represented by companies like China Airlines and EVA Air, experienced some minor share price volatility during the election period, but not sufficient to alter their year-to-date upward trajectory driven by increased travel and cargo exports. In summary, the recent election in Taiwan has not led to any substantial changes in our earnings forecasts.

The main takeaway from recent electoral events is that the continuation of Taiwan's current policies under Lai's term are expected to sustain the economic status quo and stability based on strong fundamentals in secular tailwind end markets. However, it is crucial to monitor any change in risk/sentiment.

INDIA: LOCAL PERSPECTIVES FROM OUR MUMBAI BASED PORTFOLIO MANAGER

With the participation of approximately 640 million voters, in a 6-week-long election, the world's largest democracy elected its new government on June 4, 2024. The BJP-led National Democratic Alliance (NDA) coalition won the 2024 Indian national elections narrowly, with 292 out of 543 seats in the Lok Sabha (lower house of India's bicameral Parliament). The NDA's performance was significantly weaker than both exit poll estimates and the 2019 election results. After a decade of single-party governance, India has entered an era of coalition government once again.

The drop in seats is largely linked to weaker-than-expected performance in its strongholds in Northern and Western India. On one hand, the fact that the party achieved majority rule confirms the population's support for government initiatives that have elevated India to the world's fastest growing economy. On the other hand, the narrow miss to absolute majority reflects a frustration with joblessness, rising prices, and growing inequality that have become increasingly pronounced during India's post-pandemic recovery.

While Prime Minister Narendra Modi's new dependence on coalition partners will marginally hinder the speed of policy rollout, we expect the direction of the government's policies and the principal agenda of nation-building to remain intact. The ruling party has retained core portfolios with ministerial continuity while accommodating the aspirations of the coalition partners. We should see the government continue with its focus on (1) affordable healthcare and housing, (2) energy transition, (3) infrastructure development and (4) manufacturing. In addition, an investment-led economic agenda should continue to prevail, although we may see tweaks to its priorities to support consumption and employment. Some other areas of importance could include improvement in the primary deficit, sustained growth in the domestic equity savings pool, enhanced social equity, a fast-evolving deep-tech sector, an impending loan boom, and shifts in external dynamics (continuance of lower oil intensity).

While the general policy direction should largely remain unchanged, some areas may get re-prioritized. Significant political reforms, such as Uniform Civil Code, and land/labor reforms may witness a delay as a fall-out of this electoral verdict. Public Sector Undertaking (PSU) privatizations, which have some political ramifications, could also see some delay and reviews.

The most important aspect of the BJP-led NDA retaining its majority is policy predictability, which means that India will continue to focus on macro stability – something that should anchor a bull run in stocks.

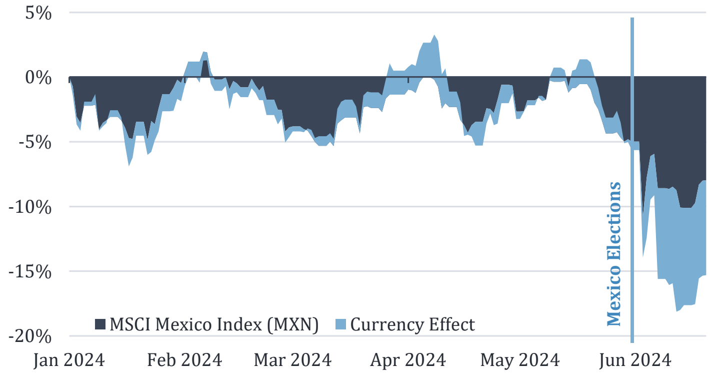
MEXICO: LOCAL PERSPECTIVES FROM OUR MEXICO CITY BASED PORTFOLIO MANAGER

On June 2nd, Mexico witnessed its largest elections in history in terms of voter participation, with 60 million people turning out to cast their votes - almost 10% more than in 2018. The result was a resounding landslide victory for the incumbent party, Morena, in all aspects. The presidential race was won with over a 30% margin, a difference not seen since the 1980s. However, this outcome had been expected and priced in for some time.

The true surprise of the elections came at the gubernatorial and congressional levels. Morena defended six governorships and gained a seventh from the opposition (out of nine governorships up for grabs in the country). Their coalition secured a "super-majority" in the lower house of congress by winning 73% of the seats and narrowly missed attaining the same result in the Senate by just a couple of seats. From the perspective of the capital markets, this outcome was unexpected and very negative, as most had anticipated the opposition to at least hinder Morena from achieving a super majority. Why is this such a crucial point? Apart from the obvious risk of a single party wielding virtually all power, President-elect Claudia Sheinbaum will assume office on October 1st, while the new congressional arrangement will commence working from September 1st onwards. This gives the current President, López Obrador, a full month to propose constitutional amendments that were previously denied or resisted, which could then potentially be passed in September with little resistance. As of now, President-elect Claudia has confirmed that discussions on Judicial/Supreme Court reform and ISSSTE reform (pension system for public employees, not part of the Afore system) among others will take place in September. We believe this will keep most investors on the sidelines, adopting a "wait and see" approach for the coming months.

The main takeaway here is that the incumbent party has essentially received a blank check from the voters to govern as they see fit. There is virtually no opposition for at least a three-year period, and Mexico will be subject to the whims of the policymakers. However, not all is grim. President-elect Scheinbaum is anticipated to be much more pragmatic than her predecessor and more market friendly. With a physics degree from National Autonomous University of Mexico (UNAM,) followed by a master's degree and a Ph.D. in energy engineering from University of California at Berkeley, there is an expectation that she will take a stronger stance on energy matters, particularly on renewable energy and public-private partnerships, as well as on nearshoring, education, healthcare, and security. She has also reiterated multiple times since the election that she will maintain an austere and responsible fiscal management approach and has reaffirmed Ramirez de la O. as Finance Minister, providing continuity for market stability. Additionally, she has already met with a delegation from President Biden's administration, indicating a willingness to discuss delicate subjects such as organized crime and immigration.

Mexican Equities and Currency Fall Post Elections



Discounted Price-to-Earnings in Mexico

Source: Bloomberg as of June 20, 2024. Graph is presented for illustrative purposes only and should not be relied on to make an investment decision.

For us as Mexico investors, this general sell-off presents an opportunity to discover great stocks at significant discounts and gradually build strong positions. In response to the election, we have shifted towards defensive stocks, such as those benefiting the most from a depreciation of the Mexican Peso like Gruma or Cuervo, or those with a substantial portion of sales in the U.S. & abroad like GCC, Chedraui, or Cemex. Some sectors, such as banking, have been heavily impacted due to vulnerability to regulations. However, in our view, this presents generous discounts and attractive entry points. Mexico had already been perceived as an overheated market in recent months, with investors steering away due to high valuations, but as of now, the market trades below 12x P/E, offering a 25% discount to historical levels. We believe that once the noise settles in the coming months, Mexican equities will once again be one of the most attractive options in the emerging markets landscape.

SOUTH AFRICA: LOCAL PERSPECTIVES FROM OUR JOHANESBURG BASED PORTFOLIO MANAGER

The South African population cast their presidential votes on May 29th, 2024. The result was an election that has catalyzed a profound shift in South Africa's political landscape, carrying implications for the nation's stability, policy trajectory, and economic outlook. The outcome, as widely anticipated, signals the dawn of a "collaboration" era, driven by the African National Congress's (ANC) diminished share of the national ballot, plummeting from 57.5% to a striking 40.2%. This result was a meaningful departure from the status quo of the last 3 decades throughout which the ANC consistently won absolute majority of the national vote and ruled South Africa. Forecasts had pegged the ANC's result closer to 45%, a threshold that would have allowed it to potentially form a national coalition independently, excluding key players like the Democratic Alliance (DA), Economic *Freedom Fighters (EFF) or uMkhonto weSizwe Party (MKP).*

Ultimately, the ANC had two choices – to push further to the left to form a government of national unity (GNU) or to form a centrist government. The ANC chose to form a centrist government with the DA and Inkatha Freedom Party (IFP) as the two next largest parties. In total, the GNU makes up 68% of the national ballot, so it is in a strong position to execute its mandate. Out of all the plausible outcomes that could have occurred in this election, we consider this outcome to be the best possible for the country and its medium-term prospects.

The key risk is whether the GNU can hold together and continue with the reform agenda that began approximately a year ago. Should they be able to maintain unity, we expect a noticeable reduction in fiscal risk premiums, a stronger rand, and given starting valuations, we believe that domestically focused shares within South Africa should outperform emerging market peers. Positioning in South Africa from both local and offshore investors continues to be very low, and we expect that to normalize over time as the reform agenda continues to progress.

Additionally, the positive reforms at Eskom and Transnet are encouraging signs. We are optimistic about South Africa's economic outlook for the next 1-3 years, particularly for equities. These reforms are expected to enhance the operational efficiency and reliability of these critical infrastructure entities, further supporting economic growth.