COLUMBIA THREADNEEDLE INVESTMENTS

Opportunities in a changed emerging markets universe

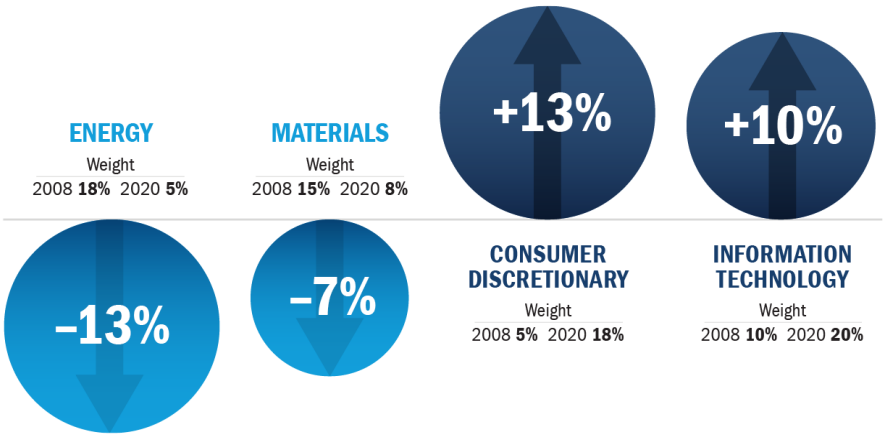
February 9, 2021

The COVID-19 pandemic has done little to disrupt the powerful structural trends driving growth in emerging markets.

As we enter 2021, the macroeconomic backdrop for emerging markets is extremely promising. Economies like China and South Korea were among the first to be hit by the pandemic, and their robust approach to tackling its spread have helped power strong recoveries. We believe they'll continue. Generally, emerging markets are benefiting from the global wave of interest-rate cuts and liquidity injections by central banks. Significant long-term structural change is also driving EM, and these changes will create opportunities that outlast the pandemic.

How has the composition of emerging markets changed?

Changes in sector weights over the past 13 years



Source: Columbia Threadneedle Investments. Chart shows the variation in sector weight in the MSCI Emerging Markets index between 01/31/08 and 01/31/20. Real estate, which was not included in the index in 2008, is excluded. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. It is not possible to invest directly in an index.

We believe the key long-term trend driving emerging markets is their transition from export-led growth to reliance on buoyant domestic demand. And this will assert itself more strongly than ever. Nowhere is this clearer than in the shift of the global middle classes. In October, the Brookings Institution pointed out that China is experiencing the fastest middle class expansion the world has ever seen.* This continuing shift will fuel strong domestic demand for goods and services, a significant proportion of which will be met by fast-growing domestic companies.

Dara J. White, CFA
Global Head of Emerging Markets Equity

Elsewhere, there are pockets of growth in financials thanks to digital innovation. In Brazil, record-low interest rates are driving investment in equities and creating opportunities. As financial deregulation, structural reform and technology adoption continue, areas such as digital brokerage and payments are likely to yield more prospects for high growth. And although the pandemic has somewhat slowed the reform agenda in emerging markets, the long-term trend is still intact. Important reforms are progressing in countries including Brazil, Indonesia, India and China.

We see significant opportunities with global growth potential in 2021 across consumer discretionary, information technology and communication services sectors as businesses develop products and services to meet evolving consumer tastes.

Bottom line: Many investors remain under-allocated to emerging markets, but the case for owning this asset class is only growing stronger. We have seen an increasing number of companies with quality growth characteristics, strong, investor-friendly management teams and the ability to fund their growth internally while increasing their returns on invested capital. The growth and diversification benefits are compelling, and we believe the coming year will offer attractive opportunities to increase exposure.

DISCLOSURES:

*"China's influence on the global middle class," The Brookings Institution, October 2020.

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CTBPKRT (02/22) 4237500