Emerging Markets Update
Summer 2020

IS THIS TIME DIFFERENT?

EM EQUITIES, LOOKING FORWARD

The lens of history combined with an understanding of how economies across the globe are changing can provide valuable insight for emerging markets (EM) investors seeking long-term capital growth. EM have historically rebounded strongly after periods of crisis. The repetition of this pattern, in its initial phase, appears to have started during the first half of this year with EM equities rallying in response to growing optimism about the potential containment of Covid-19.

Whether this optimism continues is hard to predict, with many epidemiologists anticipating increasing numbers of new Covid-19 cases as economies continue to re-open. Nevertheless, we believe the first half of 2020 reinforces our thesis that EM often repeat a pattern over long-term periods in response to crises. In this commentary we explore this pattern and explain how economic changes in developing countries may bode well for EM equities.

Gregory M. Jones, CFA
SENIOR VICE PRESIDENT
PORTFOLIO MANAGER

Pragna D. Shere, CFA
SENIOR VICE PRESIDENT
PORTFOLIO MANAGER

Emerging Markets Rally After Dropping Dramatically

The MSCI Emerging Markets Index dropped approximately 33.9% from January 17 to March 23 in response to fears over an anticipated global recession resulting from the pandemic. While the decline was similar to that of the S&P 500 and MSCI EAFE (Europe, Australia and the Far East, or developed markets ex U.S.), several EM countries experienced sharper falls with Brazil and Russia declining more than 50%. After reaching a low in late March, the MSCI Emerging Markets Index rebounded 31.2% as of June 30. With the pandemic still expanding rapidly in many developing countries–specifically Brazil and India–but appearing to moderate in the U.S. and other developed countries, the S&P 500 and MSCI EAFE indices outpaced EM, generating 38.5% and 31.5% returns, respectively, as of June 30.

Understanding Market Cycles

The pattern of EM securities rising more sharply than the U.S. and other developed markets (DM) after a major crisis is not unusual. For EM, a crisis can cause investors to flock to the safety of the U.S. dollar, treasuries and other safe havens, such as the Swiss franc. During the stampede, certain EM assets–equities, debt, and currencies-can experience reduced marketability and liquidity, thereby exacerbating price declines. Additionally, many developing countries are leveraged to global growth and trade flows and are reliant on external funding and direct investment. These factors, in turn, can reinforce negative news regarding global growth and other factors, which sustains a negative feedback loop.

Notwithstanding these fears, most of which have been supported by current and longer term structural deficiencies and problems, it is human nature to engage in excessive selling of EM equities. This overreaction creates opportunities for equities to eventually rally. As such, EM have historically outperformed the U.S. and other DM during the 12 to 18 months after the zenith of a crisis. Consider the following:

- During the Severe Acute Respiratory Syndrome (SARS) epidemic of early 2003, equities of countries most impacted by the crisis underperformed, but then generated strong absolute and relative performance during the subsequent 12 months. During this crisis, China, Taiwan and South Korea suffered the greatest impact as represented by declines in dollar terms of MSCI indices of 15.3%, 19.0% and 31.3% respectively, from their corresponding peaks in December 2002 and January 2003 to their lows in March and April of 2003. In contrast, in the U.S., the S&P 500 fell 14.0% from January 14, 2003, to March 5 of the same year. As new SARS cases peaked, China, Taiwan and South Korea markets began to recover. Over the following 12 months, with peak equity levels achieved in all four countries in early March of 2004, the gains were as follows: MSCI China, 106.1%; MSCI Taiwan, 77.9%; and MSCI Korea, 95.4%. The return for the S&P 500 from the 2003 low to March 4, 2004, was 44.5%.
- During the Global Financial Crisis (GFC), EM equities bottomed in late October of 2008 with the MSCI Emerging Markets Index recording a 66.1% loss from one year earlier. Developed markets experienced smaller but still significant losses with the MSCI EAFE Index and the S&P 500 Index declining 61.8% and 56.5%, respectively, peak to trough. To counteract the impact of the GFC, the Chinese government announced a stimulus program valued at more than 10% of the country's gross domestic product. Markets responded with EM eventually outperforming developed markets. From its October 27, 2008, trough to November 4, 2010, the MSCI Emerging Markets Index climbed 153.4% while the MSCI EAFE and S&P 500 indices gained 83.8% and 79.5%, respectively, from their March 9, 2009, troughs.

A Look at Today's Markets

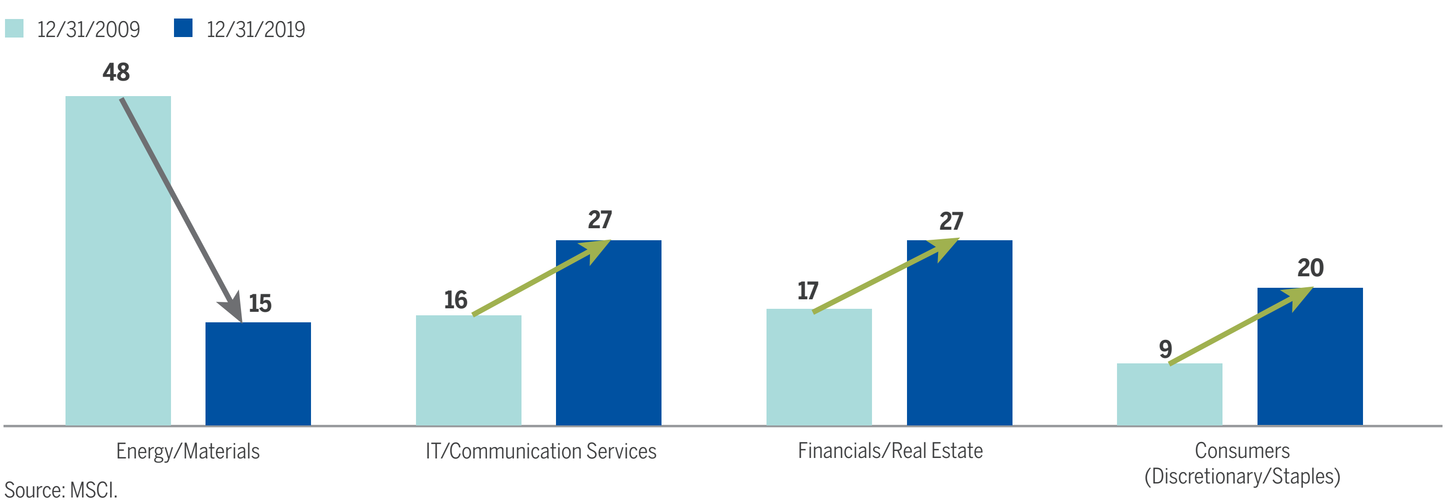
The major departure from prior periods is that this current crisis impacts virtually every country worldwide, and countries are experiencing different timelines in terms of infection rates, case growth, shelter in place and lockdown restrictions, and adherence to those policies. In this regard, many developing countries have lagged China, Korea, Europe and the United States. As cases peaked in China, the country's equity market began to bounce back. China now stands out as one of the best-performing countries year to date. We believe other countries will follow suit as the rate of change of new cases slows or reverses in those countries. Further, as countries remove lockdowns, we will need to watch for signs of increasing rates of new Covid-19 cases that may temporarily short circuit equity market rebounds.

EM equities derive their value from superior earnings growth rates and long growth runways. In aggregate, the MSCI Emerging Markets Index could potentially generate alpha relative to the U.S. market when a combination of earnings growth, valuation and income streams favor developing countries. However, in recent years, this superior earnings growth and earnings growth visibility have been missing, leading to relative underperformance compared to the U.S.

The Changing Nature of Emerging Markets

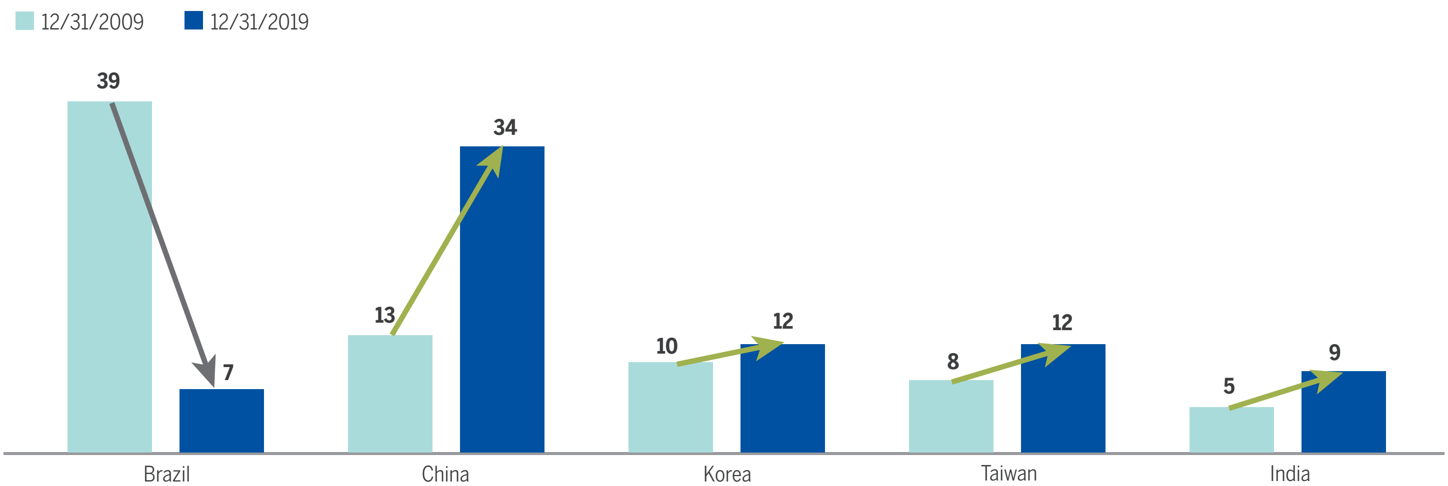
Earnings growth and valuation depend largely on the composition of the MSCI Emerging Markets Index. The composition changes over time and is a legacy of prior cycles, stage of economic development and capital markets activity, including companies changing from government to private sector ownership and initial public offerings of new economy/entrepreneurial companies (see Figure 1 and Figure 2). After the first decade of 2000, which

Figure 1: **MSCI Emerging Markets Index Select Sector Exposure (%)**



Source: MSCI.

Figure 2: **MSCI Emerging Markets Index Top 5 Country Exposure (%)**



Source: MSCI.

involved the explosive growth of China and the country's subsequent infrastructure spending surge to offset the GFC in 2008, commodity producers, basic industry and durable producers were the clear beneficiaries. However, when the sugar rush of increased infrastructure spending began to dissipate in the early part of the following decade, the composition of the EM index was skewed to commodities and basic industries. Furthermore, many countries had used the buoyant market environment up until 2008 to privatize public or quasi-public banks, basic industry companies and utilities, principally led by China. As a result, the MSCI Emerging Markets Index at the beginning of 2010 was heavily skewed toward commodities, with Energy and Materials representing nearly half the index and commodity heavy economies comprising 57% of the benchmark as illustrated by Figure 1 and Figure 2.

Finally, while most governments abstained from adding debt obligations after the GFC, non-financial/non-public sector debt expanded significantly, as well as local government/provincial level borrowing in the case of China. The net result was a period of debt consolidation and slower than trend GDP growth, which first manifested in developed countries after the GFC and then continued in developing countries at different points in time during the decade of 2010-2020.

This combination of slower-than-expected growth in China and the rest of the world and the EM benchmark being heavily weighted to commodities, resulted in a lost decade for EM in aggregate. Notwithstanding this, in a large universe there were gems among individual securities (see Figure 3).

Figure 3: **Representative Top Index Performers** (10 Years Ended 12/31/19)

Name	Cumulative Return (%)
Largen Precision	1396
Tencent	1038
Anta	798
Taiwan Semiconductor	686
TAL Education	559

Source: MSCI.
*Index is MSCI Emerging Markets Index

Going Forward

We believe the increased weighting of sectors categorized as having growth companies within the MSCI Emerging Markets Index, combined with historical data showing that equities have risen as crises resolve, implies that EM may be a potentially attractive opportunity for investors seeking long-term capital growth. As with past market cycles, however, the rising tide of improving investor sentiment is unlikely to lift all boats equally. To that end, we believe investors may be well served by using a research-driven strategy that seeks high-quality gems with strong fundamentals that can potentially outperform.

Important Disclosures: The views expressed are the views of Fred Alger Management, LLC (FAM) and its affiliates as of June 2020. These views are subject to change at any time and may not represent the views of all portfolio management teams. These views should not be interpreted as a guarantee of the future performance of the markets, any security or any funds managed by FAM. These views are not meant to provide investment advice and should not be considered a recommendation to purchase or sell securities.Holdings and sector allocations are subject to change.

Risk Disclosures: Investing in the stock market involves risks, including the potential loss of principal. Growth stocks may be more volatile than other stocks as their prices tend to be higher in relation to their companies' earnings and may be more sensitive to market, political, and economic developments. Foreign securities, Frontier Markets, and Emerging Markets involve special risks including currency fluctuations, inefficient trading, political and economic instability, and increased volatility. Active trading may increase transaction costs, brokerage commissions, and taxes, which can lower the return on investment. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Performance data quoted represents past performance. Past performance is not a guarantee of future results.

Important Information for US Investors: This material must be accompanied by the most recent fund fact sheet(s) if used in connection with the sale of mutual fund shares. Fred Alger & Company, LLC serves as distributor of the Alger mutual funds.

Important Information for UK and EU Investors: This material is directed at investment professionals and qualified investors (as defined by MiFID/FCA regulations). It is for information purposes only and has been prepared and is made available for the benefit investors. This material does not constitute an offer or solicitation to any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient, and is only intended for use by original recipients and addressees.

The original recipient is solely responsible for any actions in further distributing this material and should be satisfied in doing so that there is no breach of local legislation or regulation.

Certain products may be subject to restrictions with regard to certain persons or in certain countries under national regulations applicable to such persons or countries.

Alger Management, Ltd. (company house number 8634056, domiciled at 78 Brook Street, London W1K 5EF, UK) is authorised and regulated by the Financial Conduct Authority, for the distribution of regulated financial products and services. FAM and/or Weatherbie Capital, LLC, U.S. registered investment advisors, serve as sub-portfolio manager to financial products distributed by Alger Management, Ltd.

Alger Group Holdings, LLC (parent company of FAM) and Fred Alger & Company, LLC are not an authorized persons for the purposes of the Financial Services and Markets Act 2000 of the United Kingdom ("FSMA") and this material has not been approved by an authorized person for the purposes of Section 21(2)(b) of the FSMA.

Important information for Investors in Israel: This material is provided in Israel only to investors of the type listed in the first schedule of the Securities Law, 1968 (the "Securities Law") and the Regulation of Investment Advice, Investment Marketing and Investment Portfolio Management Law, 1995. The Fund units will not be sold to investors who are not of the type listed in the first schedule of the Securities Law.

S&P 500®: An index of large company stocks considered to be representative of the U.S. stock market. S&P 500 Index performance does not reflect deductions for fees or expenses. The Morgan Stanley Capital International (MSCI) Emerging Markets Index (gross) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. MSCI Index (gross) Index performance does not reflect deductions for fees or expenses.

The following positions represented the noted percentages of Alger assets under management as of March 31, 2020: Anta, 0.00%; Largen Precision, 0.00%; Taiwan Semiconductor, 0.00%; TAL Education, 0.00%; and Tencent, 0.04%.