

EM Equity Allocation For Q3'24

For the second half of the year, Alpine Macro expects growth convergence among major global economies, with the U.S. economy softening, European stagnation ending, and China's sluggish recovery continuing. For EM, a softening U.S. economy and falling inflation will pave the way for a dovish pivot by the Federal Reserve, removing a major headwind for EM assets.

For Q3, we maintain a pro-growth stance with a tactical overweight on China, some smaller EM Asian manufacturing-intensive markets, and cheap commodity plays.

The biggest change for Q3 is upgrading India from "underweight" to at least a benchmark weighting. While we are positive on India's growth story, we have been uncomfortable with the high valuation of its equities. However, Indian stocks' valuation froth could get bigger before a major setback, potentially entering a parabolic phase. We are downgrading Korea to make room for increased allocation to India.

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Growth And Policy Convergence

We expect world GDP growth to hover around 3% for the rest of the year, with smaller dispersion among major economies. The re-syncing of the world economy means monetary policies among major central banks will align.

The latest U.S. job report indicates positive, but below-trend growth, pointing to a soft-landing scenario with overall GDP growth resettling to sub-2%. With both unemployment and inflation surpassing the Fed's year-end targets, the Fed may soon join the ECB and other central banks in easing monetary policy.

Global manufacturing reacceleration should continue. The U.S. economy is rebalancing with weakening consumer spending and recovering manufacturing activity. China's growth weakness is concentrated in housing and consumer demand, while manufacturing is resilient with high-frequency indicators showing upside (**Chart 1**). Meanwhile, EM countries' manufacturing PMI numbers are solidly above the expansionary threshold. Strengthening manufacturing activity bodes well for commodity prices.

Tipping Point In Financial Markets: A Melt-up or Meltdown?

Agenda

- 08:10 - 08:30 **Opening Remarks : The Shifting Macro Landscape: Opportunities & Risks**
Chen Zhao, Chief Global Strategist
- 08:30 - 9:30 **Emerging Mega Trends: How Should Investors Be Prepared?**
Ruchir Sharma, Chairman of Rockefeller International and Founder and Chief Investment Officer of Breakout Capital
- 09:30 - 10:30 **Inflation, Disinflation and Fed Policy: Are We on the Right Path?**
Mike Dooley, Professor Emeritus at University of California, Santa Cruz and Chief Economist at Figure Technologies
- 10:30 - 10:45 Coffee Break
- 10:45 - 11:45 **Fireside Chat: Bull Bear Debate**
Francois Trahan, Founding Partner of The Macro Institute Versus
Jim Paulsen, Author of the Paulsen Perspectives research newsletter on Substack
- 11:45 - 12:30 **The Long and Shorts of U.S. Equities**
Gina Martin Adams, Bloomberg Intelligence Global Director of Portfolio Strategy, Chief Equity Strategist
- 12:30 - 14:15 **Luncheon Speaker: Biden Vs Trump: How The World Will Be Changed**
Greg Valliere, Chief U.S. Policy Strategist AGF Investments
- 14:15 - 15:00 **How Is AI Reshaping the Money Management Business?**
Gareth Shepherd, Co-Head of Voya Machine Intelligence (VMI) & Portfolio Manager, Voya Investment Management
- 15:00 - 15:15 Coffee Break
- 15:15 - 16:30 **Commodity Panel: Secular Trend, Energy and Prospect of ESG**
Tavi Costa, Partner/Macro Strategist at Crescat Capital
Lenka Martinek, Managing Partner, Sustainable Market Strategies, Nordis Capital
Adam Rozencwajg, Managing Partner, Goehring & Rozencwajg
- 16:30 - 17:30 **Cocktails & Networking**

Guest Speakers + Alpine Macro Strategists



Ruchir
Sharma



Mike
Dooley



Francois
Trahan



Jim
Paulsen



Gina Martin
Adams



Greg
Valliere



Gareth
Shepherd



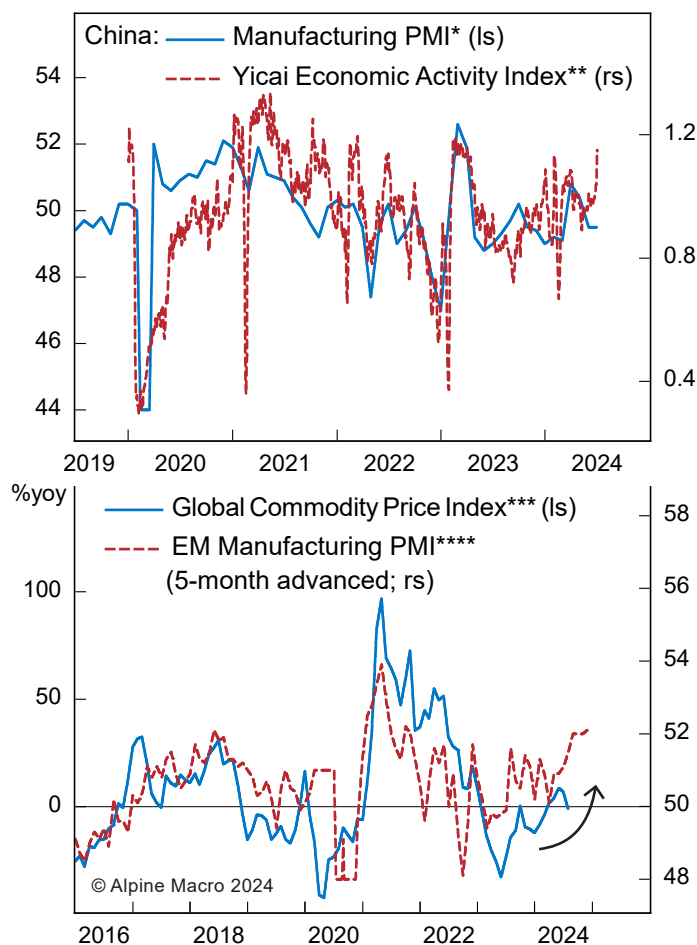
Tavi
Costa



Lenka
Martinek



Adam
Rozencwajg

Chart 1 Strengthening Momentum In EM Manufacturing Bodes Well For Commodities

*Source: China Federation of Logistics & Purchasing

**Source: Yicai Research Institute

***Source: S&P Global

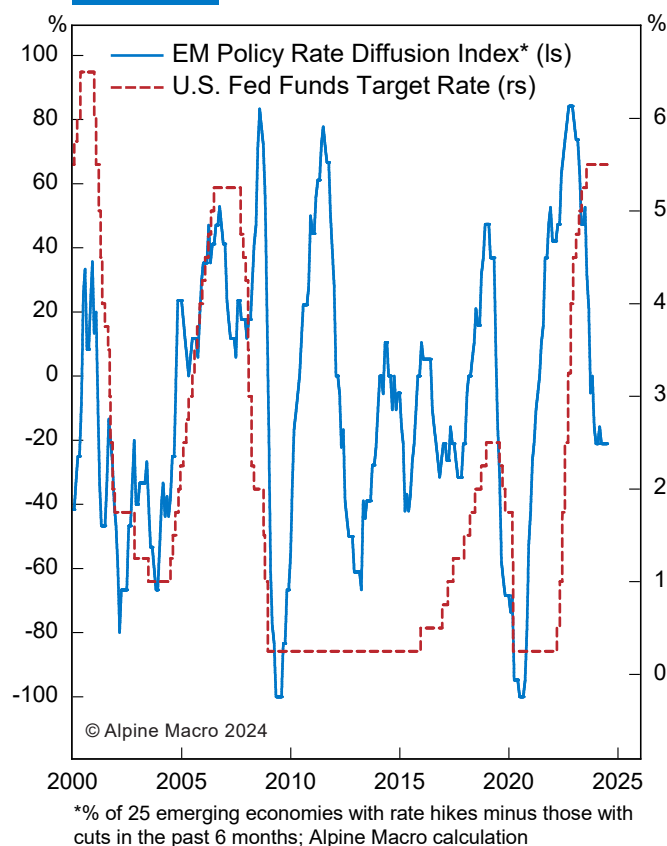
****Truncated at 48; source: S&P Global

The Fed staying “higher for longer” so far this year has forced some EM central banks to pause their easing cycles, which are set to resume once the Fed begins to cut (**Chart 2**). Overall, this should provide a positive macro backdrop for EM assets.

Performance Review

Our country allocations are guided by our EM Equity Country Allocation Model (EECAM),¹ which

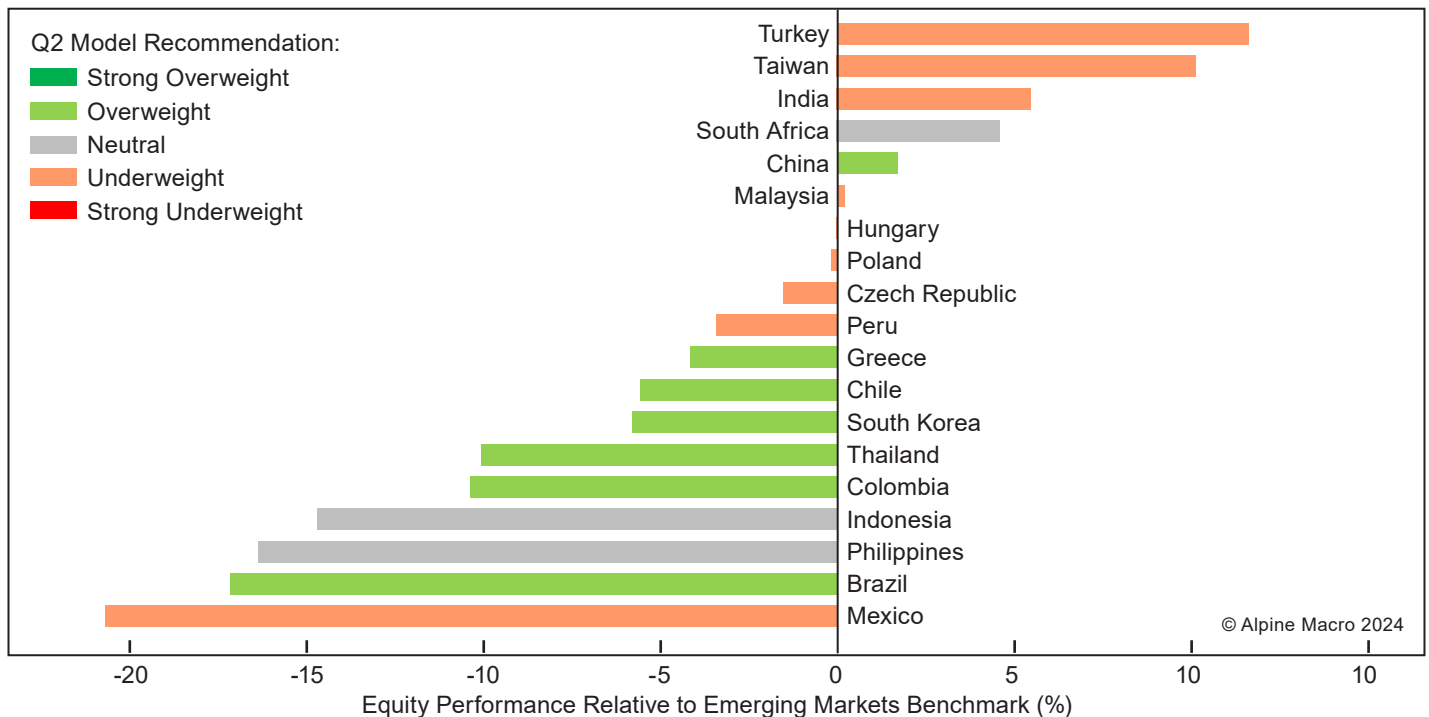
¹ Alpine Macro *EM & China Strategy* "Presenting The Alpine Macro EM Equity Country Allocation Model" (May 1, 2018).

Chart 2 EM Easing Cycle Will Resume

incorporates valuation, momentum, and growth indicators. Subjective adjustments are made to reflect our views on global macro conditions and country characteristics. For smaller markets, we mostly follow the model's recommendations, while for larger markets, model outcomes must align with our qualitative assessment.

Chart 3 shows the relative performance of various EM bourses against the benchmark over the past quarter. The model's overweight position on China was profitable, and the underweight position on Mexico was correct, as it was by far the worst performer. However, underweight positions in India and Taiwan were costly mistakes. Overall, the model portfolio underperformed the benchmark in Q2.



Chart 3 EM Equity Country Allocation Q2 2024 Scorecard**Table 1** EM Equity Country Allocation For Q3 2024

| EM Equity Country Allocation | | |
|------------------------------|-------------|-------------|
| Country | Q3 2024 | Q2 2024 |
| Brazil | Overweight | Overweight |
| Chile | Overweight | Overweight |
| China | Overweight | Overweight |
| Colombia | Overweight | Overweight |
| Greece | Overweight | Overweight |
| Thailand | Overweight | Overweight |
| South Africa | Overweight | Neutral |
| Indonesia | Neutral | Neutral |
| Philippines | Neutral | Neutral |
| India | Neutral | Underweight |
| South Korea | Underweight | Overweight |
| Czech Republic | Underweight | Underweight |
| Hungary | Underweight | Underweight |
| Malaysia | Underweight | Underweight |
| Mexico | Underweight | Underweight |
| Peru | Underweight | Underweight |
| Poland | Underweight | Underweight |
| Taiwan | Underweight | Underweight |
| Turkey | Underweight | Underweight |

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Q3 Allocation

Table 1 summarizes the model's allocation recommendations for Q3, with several notable changes.

Rethinking India: From Economic Boom To Financial Mania

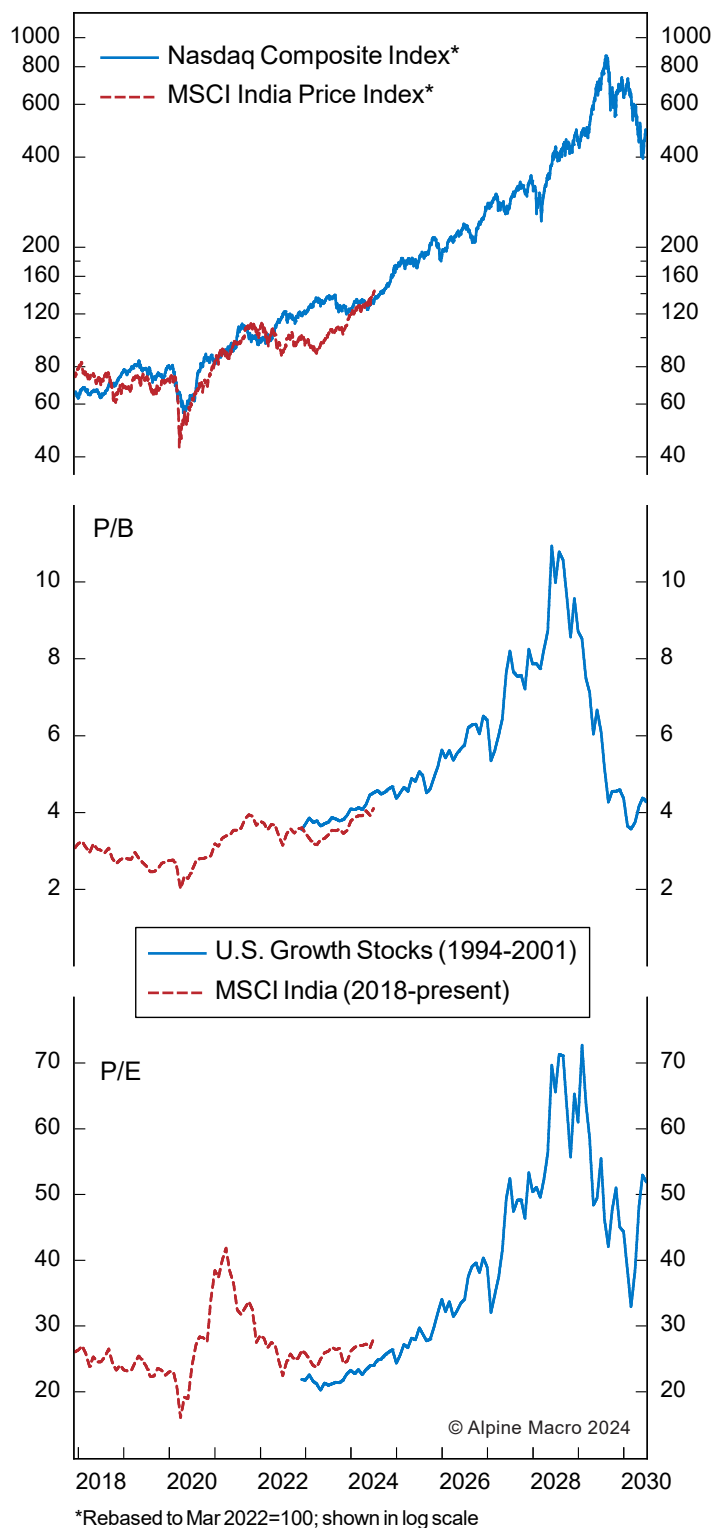
Throughout history, all financial manias begin with a real growth story. In the investment classic "Manias, Panics, And Crashes," the renowned late financial historian Charles Kindleberger laid out that a financial bubble starts with a "displacement," a shock large enough to impact the economic outlook. This leads to increased optimism among enterprises and investors, sparking a growth boom and subsequently financial market euphoria.

India fits perfectly into this pattern, and this process appears to be at an early stage. The country's growth outlook has been significantly bolstered by a combination of positive factors, including a pro-growth government, strong geopolitical tailwinds, a vast unified market, and accelerating industrialization.² Robust economic growth, rising corporate profits, and improving optimism are fueling a self-reinforcing feedback loop, resulting in a massive surge in stock prices.

Chart 4 illustrates that Indian stocks have closely tracked the NASDAQ bubble of the 1990s. They have been the top performers in EM in recent years, driving their valuation to a significant premium over the EM benchmark. This has been a key reason for our model consistently underweighting this market, which in hindsight, has proven wrong.

² Alpine Macro *EM & China Strategy* "Post-Elections: Back To Basics" (June 11, 2024).

Chart 4 India: A Mania Candidate



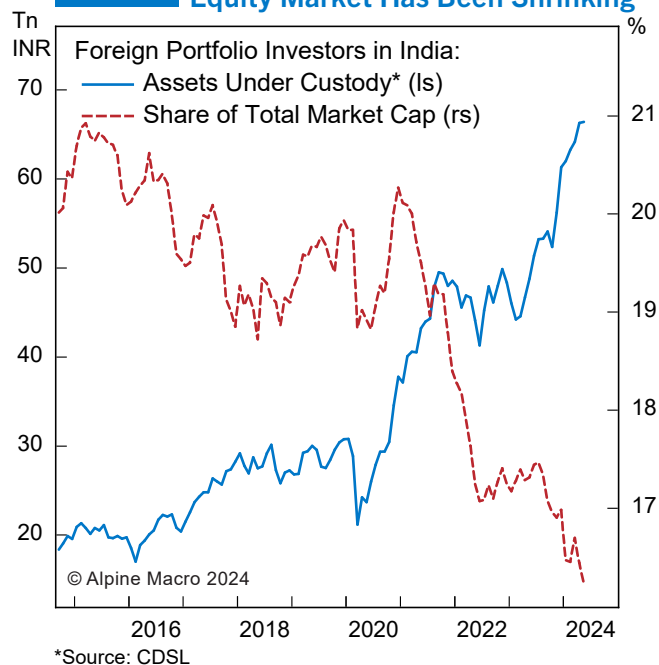
Looking ahead, we anticipate the powerful rally in Indian equities to continue, and not allocating enough to this market could mean missing out on one of the world's largest investment opportunities in the coming years. Therefore, we are upgrading India to at least benchmark weight and plan to increase exposure further on any major setbacks.

First, history suggests that valuation froth can escalate significantly in a financial mania, as depicted in the lower panels of [Chart 4](#). During the peak of the U.S. tech mania in the 1990s, equity multiples of U.S. growth stocks were more than double the current levels of Indian stocks. Similarly, at the peaks of the "Japan bubble" in 1989, the "Asia bubble" before the Asian Crisis, and the "China bubble" in 2007, these markets traded at much higher multiples than India does today.

Second, investor sentiment towards India has improved considerably in recent years, but it does not yet appear euphoric. There are signs of retail-driven frenzy, particularly among domestic investors, but foreign investors have been more cautious. Foreign holdings of Indian equities have risen substantially, primarily due to price appreciation rather than fresh capital inflows ([Chart 5](#)). Foreign holdings as a percentage of total Indian market cap have declined since 2021 to their record low level.

Moreover, our discussions with clients indicate that our concerns about valuation in Indian stocks are widely shared among investors, indicating a lack of euphoria. Similarly, fund flow data suggests that EM funds have consistently maintained allocations to Indian equities below benchmark weights.

Chart 5 Foreign Participation In Indian Equity Market Has Been Shrinking

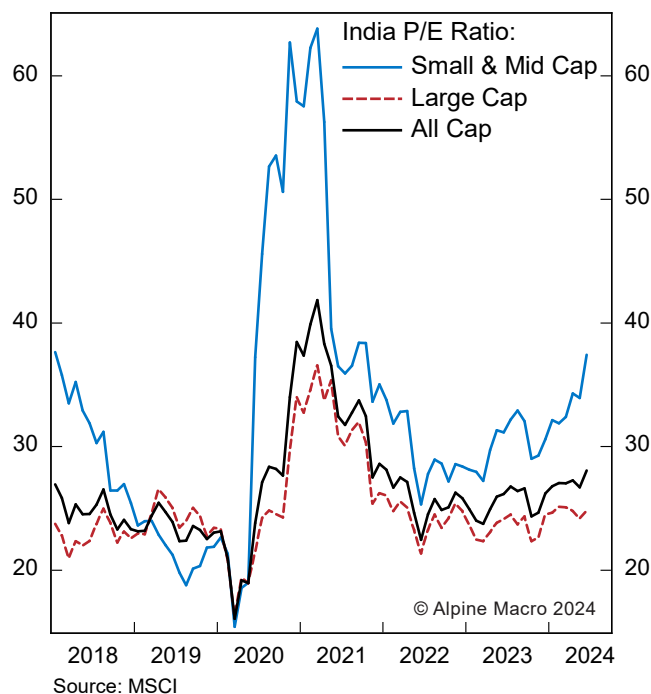
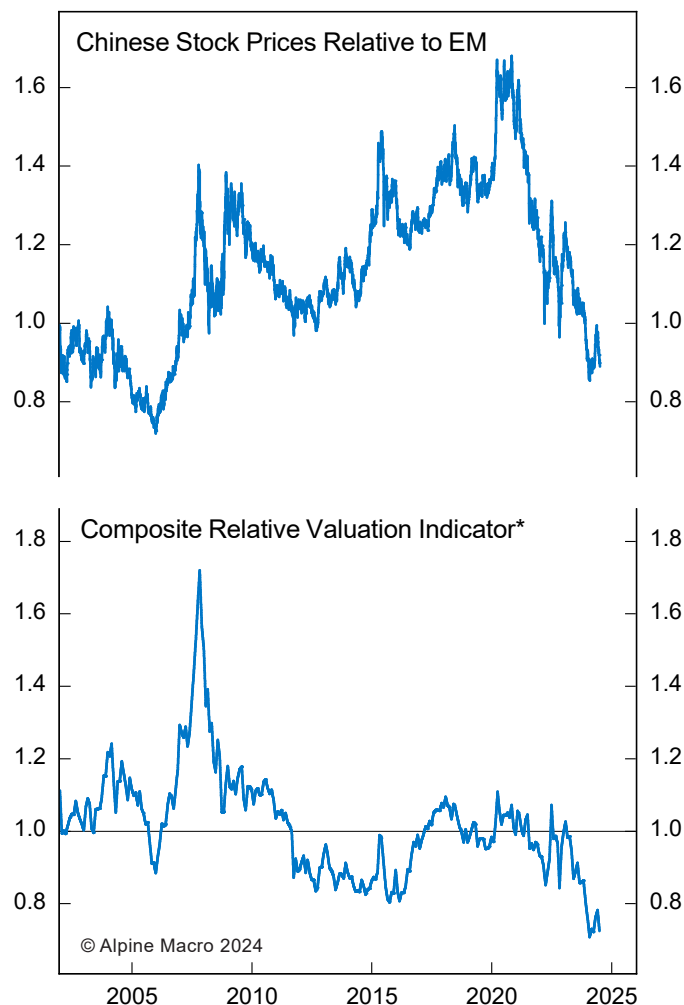


Fiduciaries may face increasing pressure to raise exposure to India, for fear of missing out, if the market continues to outperform.

Finally, for investors wary of valuation froth in Indian equities, large-cap stocks may present a safer option, as they are the cheapest segment of the market ([Chart 6](#)). Overtrading and speculative behavior, largely driven by local retail investors, are more pronounced in mid and small-cap names. Large-cap Indian stocks are trading at 25 times trailing earnings, compared to 38 times for mid and small caps.

The bottom line is that we acknowledge our mistake in underweighting India in our EM model portfolio and are upgrading our stance for Q3, despite valuation concerns. The country's significantly improved growth outlook and rising optimism align well with the characteristics of a developing financial "mania." We will follow up on this issue in an upcoming report.



Chart 6 Indian Large Caps Are Cheaper**Chart 7** Remain Overweight On Chinese Stocks In EM

*Calculated as an average of relative trailing P/E, forward P/E and P/B ratios; source: MSCI

China: Remain Tactically Overweight

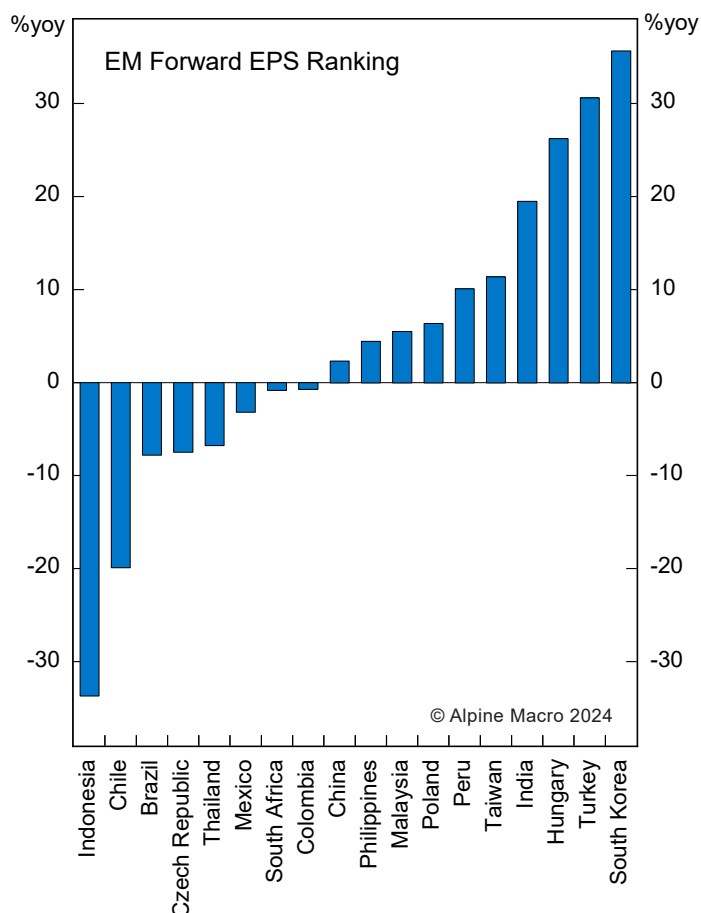
Beijing's lack of decisive reflation measures to backstop the housing meltdown and consumer retrenchment is deeply worrying, as we discussed in an earlier report,³ but we are staying with an overweight position for Q3.

The most important consideration is that we believe Chinese stocks have priced in an economic deterioration that is far worse than what Beijing will likely tolerate (Chart 7). Even as policy-makers continue to drag their feet in supporting the economy, they will have to step up easing measures if the economy slips anew. The fact that Chinese stocks outperformed the EM benchmark strongly between February and May suggests that financial markets would respond positively to positive policy catalysts.

In addition, the Chinese Communist Party is going to hold the third plenum of the 20th Party Congress next week. Historically, such events have played pivotal roles in policy liberalization and reforms. There are heightened expectations that the upcoming third plenum will address some key issues to bolster business and consumer confidence, ease local governments' fiscal woes, and search for new growth impetus. Stay tuned.

3 Alpine Macro *EM and China Strategy* "China: A Critical Spot" (June 25, 2024).



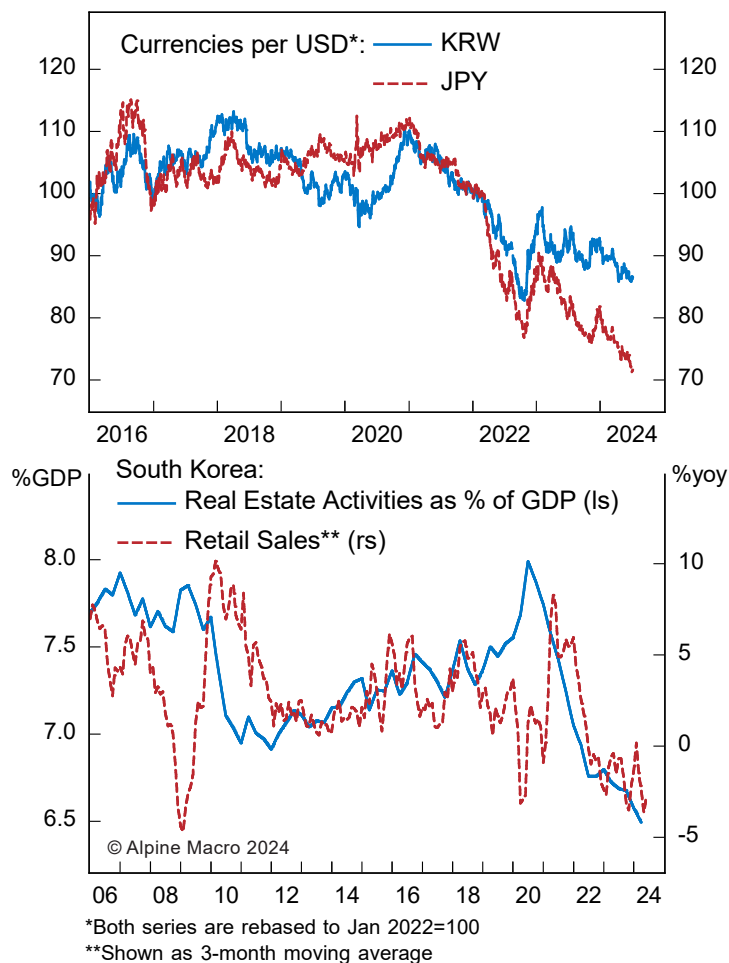
Chart 8 Earnings Expectation In EM

Source: MSCI

Downgrade South Korea

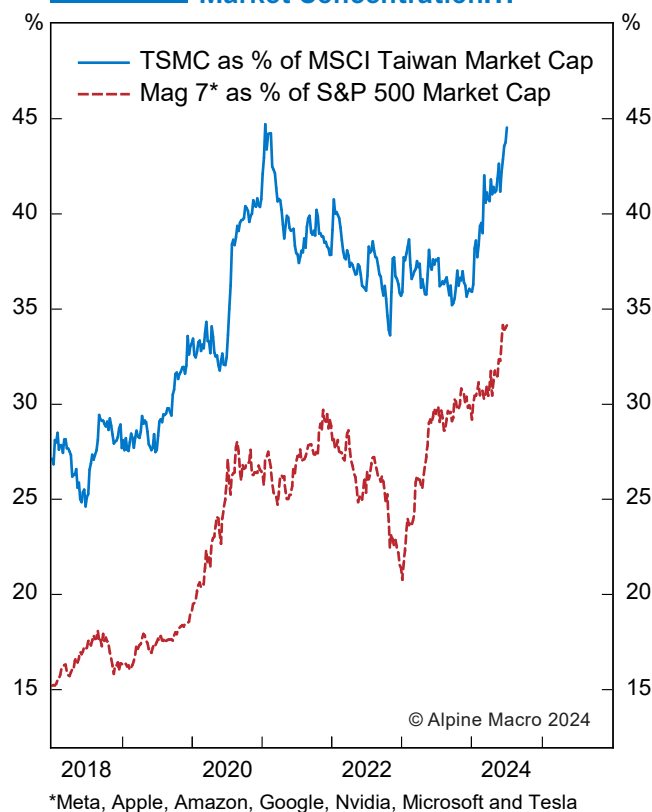
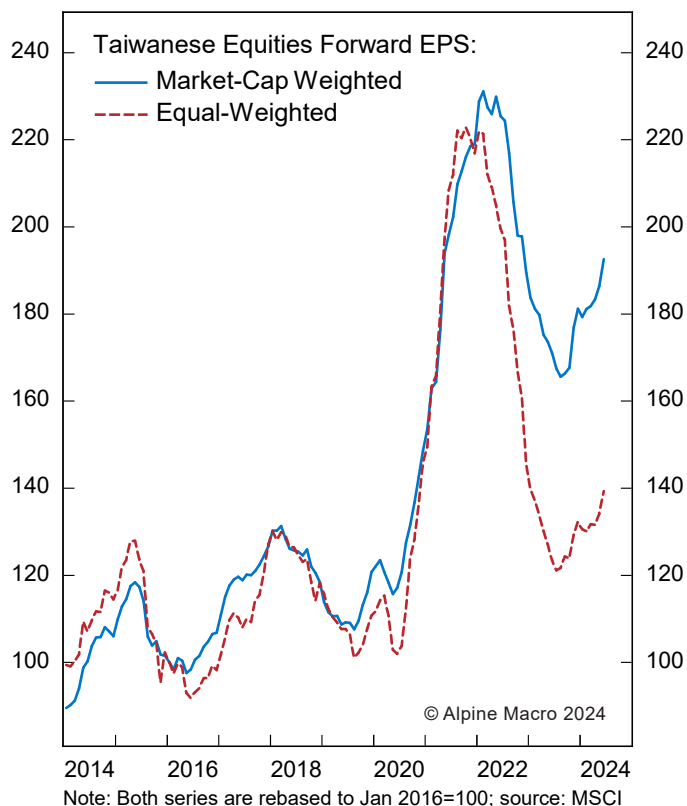
We are downgrading South Korea to "underweight" to allow for increased allocation to India. This tech-heavy market has shown very weak momentum and has not benefited from the global tech/AI boom. Korean stocks are also not particularly cheap, and roughly on par with the EM benchmark based on our composite valuation indicator.

Meanwhile, analysts expect a sharp improvement in Korean equity earnings, the most optimistic assessment in EM (Chart 8). This could be a tall order, as Korea's cyclical outlook is challenging.

Chart 9 Korea Economy Faces External And Domestic Challenges

- Externally, its competitive advantages in some of its traditional strongholds, such as electronics and automobiles, are challenged by China. The Japanese yen's dramatic depreciation is also a further deflationary shock for Korean exporters (Chart 9).
- Domestically, the country has been suffering from a real estate recession, and similar to China, the authorities' policy response has been far too conservative, severely undermining domestic demand (Chart 9, bottom panel). All of this should limit the earnings outlook, setting the stage for disappointment.



Chart 10 Taiwan: Increasing Market Concentration...**Chart 11 ... And Bifurcation**

A Word On Taiwan

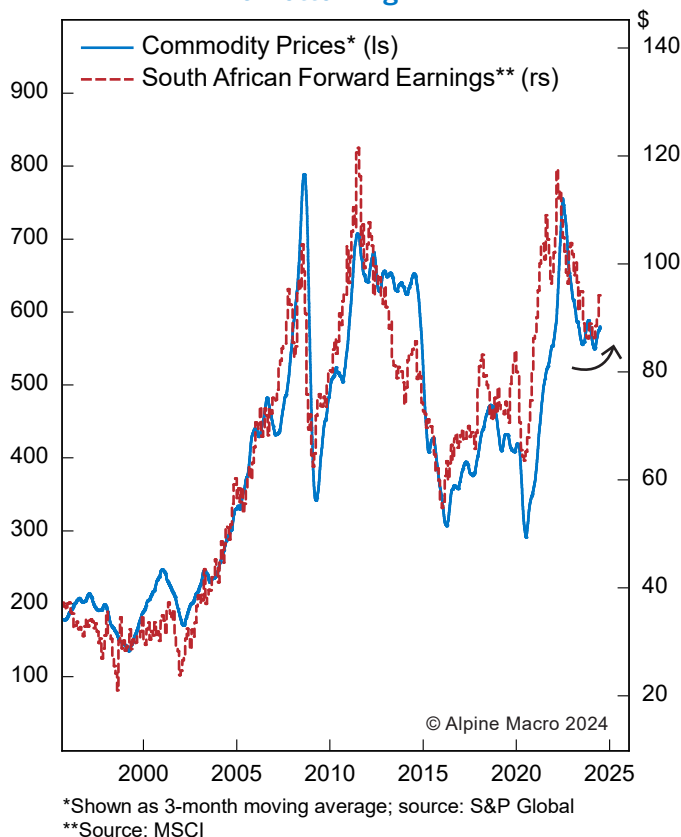
The U.S. "Magnificent 7" make up over 30% of the S&P 500 market cap, exposing market performance to idiosyncratic factors rather than macro factors. In Taiwan, the concentration is far greater, as Taiwan Semiconductor Manufacturing Company (TSMC) alone accounts for nearly half of the Taiwanese equity market (Chart 10). Driven by the AI boom, TSMC has played a key role in driving the earnings and price performance of the Taiwanese benchmark index versus EM. The earnings of the Taiwanese equal-weight equity index have been much less robust (Chart 11).

As a macro team, we are not qualified to comment on the micro specifics of TSMC, but macro factors are not promising.⁴ Simply put, Taiwan's dominance in advanced chip manufacturing is geopolitically intolerable for the world's great powers, and all major economies – the U.S., Japan, Europe, and China – are ramping up semiconductor R&D and manufacturing. This puts Taiwan at risk of being hollowed out in one of its crucial economic sectors.

The bottom line is that Taiwan's stock market will continue to follow the global tech/AI cycles, but its dominance in semiconductors is increasingly challenged. This warrants a more cautious stance for investment strategy over the long run.

⁴ Alpine Macro *EM and China Strategy* "Taiwan Presidential Inauguration And A Steamy Summer Of EM Politics" (May 28, 2024).



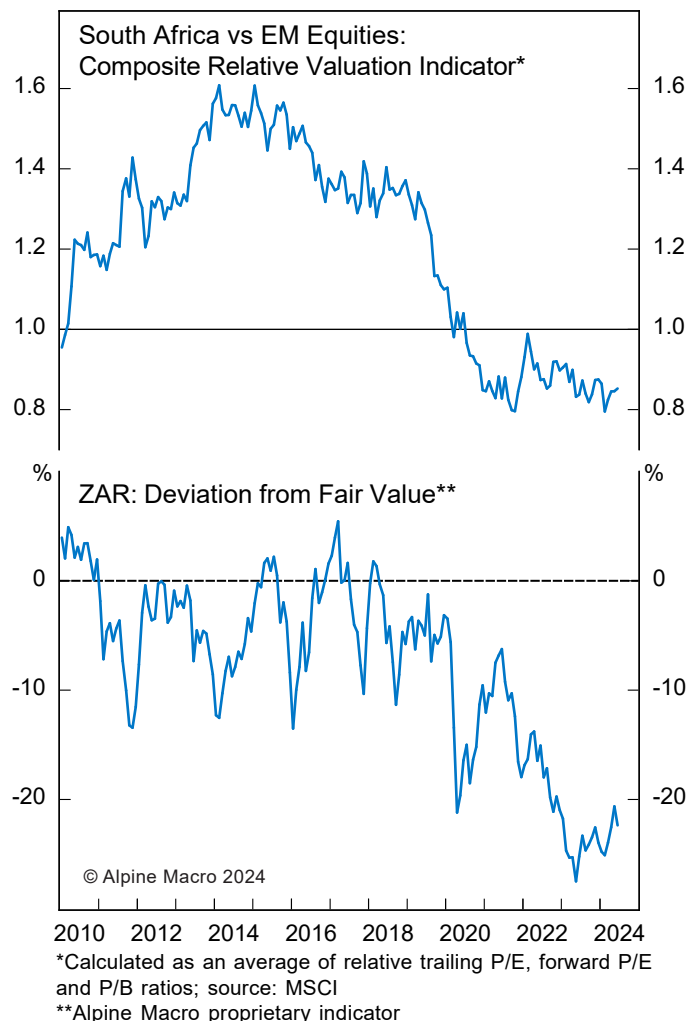
Chart 12 South African Earnings Are Bottoming

Upgrade South Africa

For Q3, we are upgrading South Africa back to "overweight" from benchmark weight, driven by eased immediate political risks and positive cyclical factors.⁵ In a nutshell:

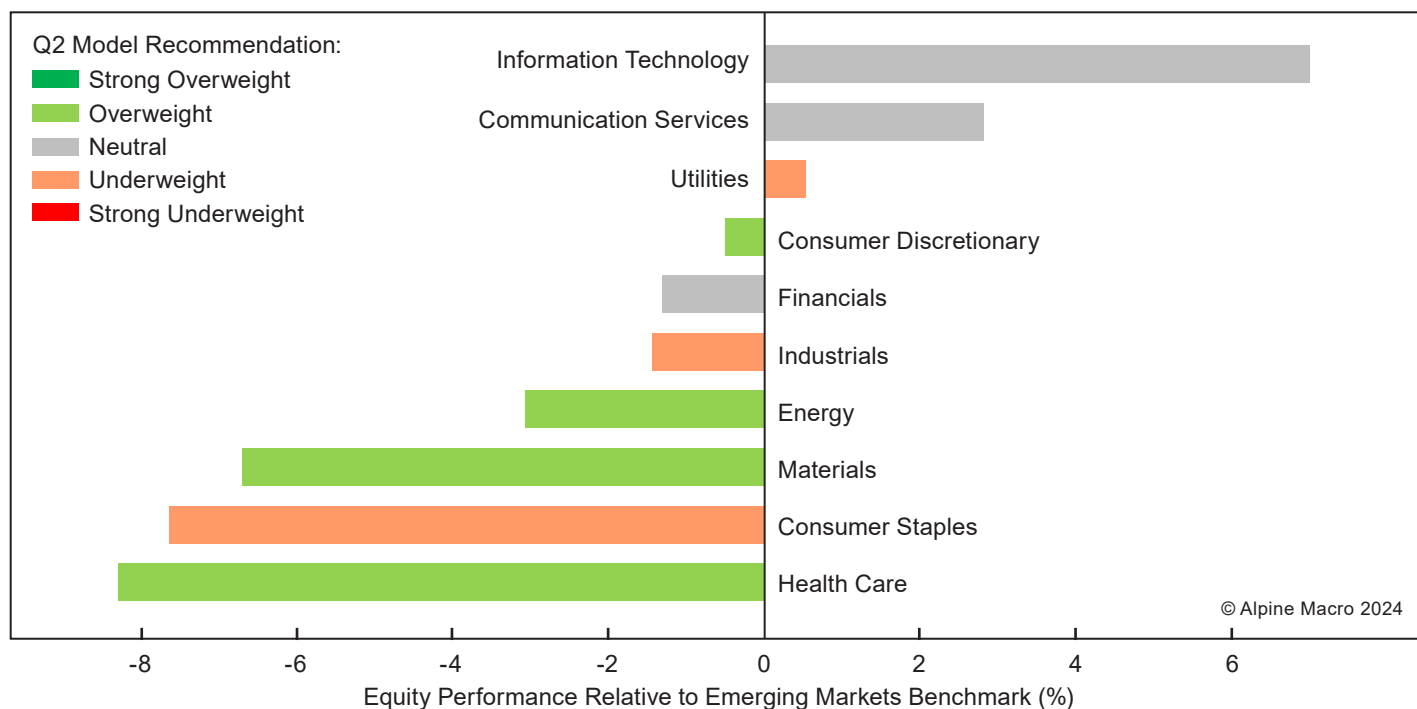
- An ANC-DA coalition is the best possible scenario for the election, even though its sustainability remains questionable. This coalition would impose checks and balances on the ANC and ensure economic and policy stability, contrasting with the much-dreaded scenarios of the ANC teaming up with radical left-wing parties. Business confidence is likely to improve.

⁵ Alpine Macro EM and China Strategy "South Africa: Clashing Political And Economic Crosscurrents" (April 23, 2024).

Chart 13 Undervalued And Undershoot

- Economically, South Africa stands to benefit from rising commodity prices. Corporate earnings likely have bottomed out (Chart 12).
- From a financial market perspective, South African assets are undervalued, with stocks trading at approximately a 20% discount to a deeply beaten-down EM benchmark. Our fair value models indicate its exchange rate as the most undervalued among major EM currencies (Chart 13). Positive political developments and stabilizing earnings are expected to catalyze South African stocks to outperform.



Chart 14 EM Equity Sector Allocation Q2 2024 Scorecard

However, these factors do not address South Africa's structural challenges, characterized by low savings, poor productivity, and a deteriorating political and policy environment. It remains to be seen whether the ANC's loss of political dominance can lead to some soul-searching to reform and improve governance.

Meanwhile, our model maintains overweight positions in undervalued commodity plays in Latin America, specifically Brazil,⁶ Chile, and Colombia, driven by improved earnings prospects and depressed valuations.

EM Sector Allocation

Similar to our country allocation recommendations, our EM equity sector allocation strategy relies on a quant-driven process supported by our EM Equity

Sector Allocation model, complemented by our subjective assessment.⁷

Our sector allocation model slightly outperformed the benchmark in the past quarter (Chart 14). Information Technology and Communication Services, which the model maintained at benchmark weight, significantly outperformed other sectors. Their heavy weights in the EM benchmark essentially mean that all other sectors underperformed the broader index. The model's overweight allocation to Consumer Discretionary and underweight on Consumer Staples contributed positively to its Q3 performance.

6 Alpine Macro *EM and China Strategy* "Brazil: Which Lula Is Showing Up?" (July 2, 2024).

7 Alpine Macro *EM and China Strategy* "Presenting The Alpine Macro EM Equity Sector Allocation Model" (September 18, 2018).



Table 2 EM Equity Sector Allocation For Q3 2024

| EM Equity Sector Allocation | | |
|-----------------------------|-------------|-------------|
| Sector | Q3 2024 | Q2 2024 |
| Energy | Overweight | Overweight |
| Materials | Overweight | Overweight |
| Health Care | Overweight | Overweight |
| Consumer Discretionary | Overweight | Overweight |
| Communication Services | Neutral | Neutral |
| Information Technology | Neutral | Neutral |
| Financials | Neutral | Neutral |
| Industrials | Underweight | Underweight |
| Consumer Staples | Underweight | Underweight |
| Utilities | Underweight | Underweight |

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For Q3, the model's sector allocation recommendations remain unchanged ([Table 2](#)), with continued emphasis on resource plays and the consumer discretionary sector.

Yan Wang, CFA

Chief Emerging Markets & China Strategist

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Investment Recommendations

Tactical Investment Positions (3 - 6 months)

| Recommendations | Open Date | Closing Date | Total P&L | Notes |
|---|------------|--------------|-----------|--|
| Short CZK/HUF | 06/05/2023 | - | 4.3% | Short Czech Koruna versus Hungarian Forint; rolling stop point at -5%, or -3.9% from current level. |
| Long Colombian 10-year Government Bond, Currency Unhedged | 11/21/2023 | - | 6.7% | Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%. |
| Long MSCI Greece Equity Index | 11/21/2023 | - | 13.0% | Long MSCI Greece Equity Index in US\$ terms; stop point at -10%. |
| Short TWD/ A Basket of BRL, COP and CLP | 11/28/2023 | - | 0.6% | Short TWD vs A Basket of Latam Currencies (Equal-Weighted of BRL, COP and CLP); stop point at -10%. |
| Long CSI 300 Index | 02/20/2024 | - | -0.2% | Long China A-shares Index in US\$ terms; stop point at -10%. |
| Long MSCI China Equity Index | 02/20/2024 | - | 11.1% | Long MSCI China Equity Index in US\$ terms; rolling stop point at -10%, or -9.6% from current level. |
| Short COP/CLP | 03/05/2024 | - | 6.0% | Short Colombian Peso versus Chilean Peso; rolling stop point at -5%, or -5% from current level. |
| Short THB/IDR | 03/05/2024 | - | 0.4% | Short Thai Baht versus Indonesian Rupiah; stop point at -10%. |
| Long Indian 10-year Government Bond, Currency Unhedged | 06/04/2024 | - | 1.0% | Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%. |

EM Equity Country Allocation

| Strong Overweight | Overweight | Neutral | Underweight | Strong Underweight |
|-------------------|--|-----------------------------------|--|--------------------|
| | Brazil Chile China Colombia Greece Thailand South Africa | Indonesia Philippines India | South Korea Czech Republic Hungary Malaysia Mexico Peru Poland Taiwan Turkey | |

EM Equity Sector Allocation

| Strong Overweight | Overweight |
|--|--|
| | Energy Materials Health Care Consumer Discretionary |
| Neutral | |
| Communication Services Information Technology Financials | |
| Strong Underweight | Underweight |
| | Industrials Consumer Staples Utilities |

EM Local-Currency Government Bond Allocation

| Overweight | Neutral | Underweight |
|---|---|---|
| Indonesia Peru Brazil Colombia Chile India | Poland Hungary South Korea Malaysia Philippines South Africa Mexico | Czech Republic Thailand China Taiwan Turkey |



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