

EM Equity Allocation For Q4'24

For EM investors, one of the key macro events to monitor in the coming months is whether China's latest stimulus measures will successfully revive the economy (Chart 1). What differentiates the current efforts from previous ones is that Beijing no longer views "massive stimulus" as taboo. Shedding this policy restraint suggests that more easing measures are likely if growth conditions do not improve.¹ This implies that the "reflation trade" for Chinese equities will have further to run.

In the past quarter, our asset allocation decisions have mostly worked out well, and our model portfolio has significantly outperformed the EM benchmark. For Q4, we remain overweight on China, smaller manufacturing-focused EM Asian markets, and some beaten-down commodity plays in Latin America, as distressed assets and as a hedge against geopolitical risks from the Middle East. We are also downgrading India and upgrading Korea.

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Performance Review

Our country allocations are guided by our EM Equity Country Allocation Model (EECAM),² which incorporates valuation, momentum, and growth indicators. We make subjective adjustments to reflect our views on global macro conditions and country-specific factors. For smaller markets, we primarily follow the model's recommendations, while for larger markets, model outcomes must align with our qualitative assessments.

- 1 Alpine Macro *Special Alert* "China's 'Whatever It Takes' Moment?" (September 24, 2024) and "More On China And EM Scorecard" (October 1, 2024).
- 2 Alpine Macro *EM & China Strategy* "Presenting The Alpine Macro EM Equity Country Allocation Model" (May 1, 2018).

Chart 1 China: Will Spike In Stock Prices Lead To Stronger Growth?

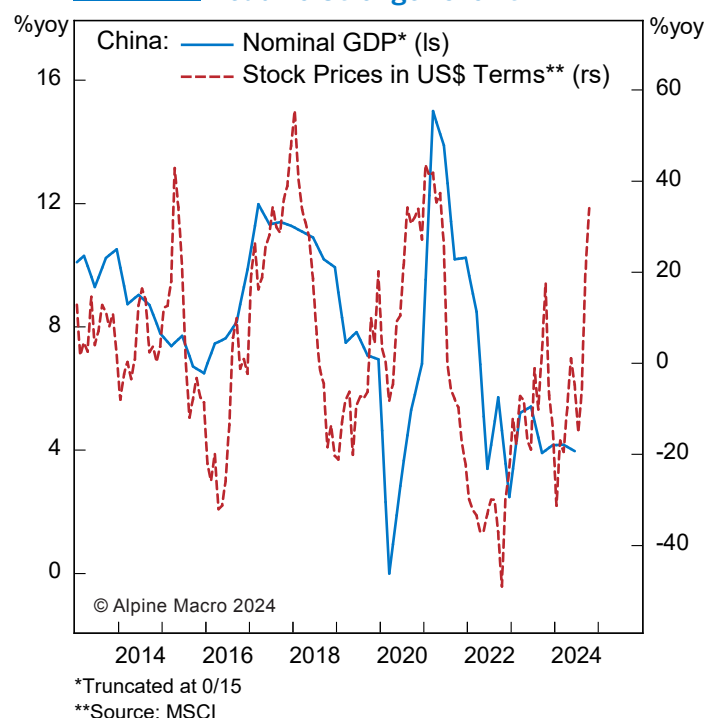
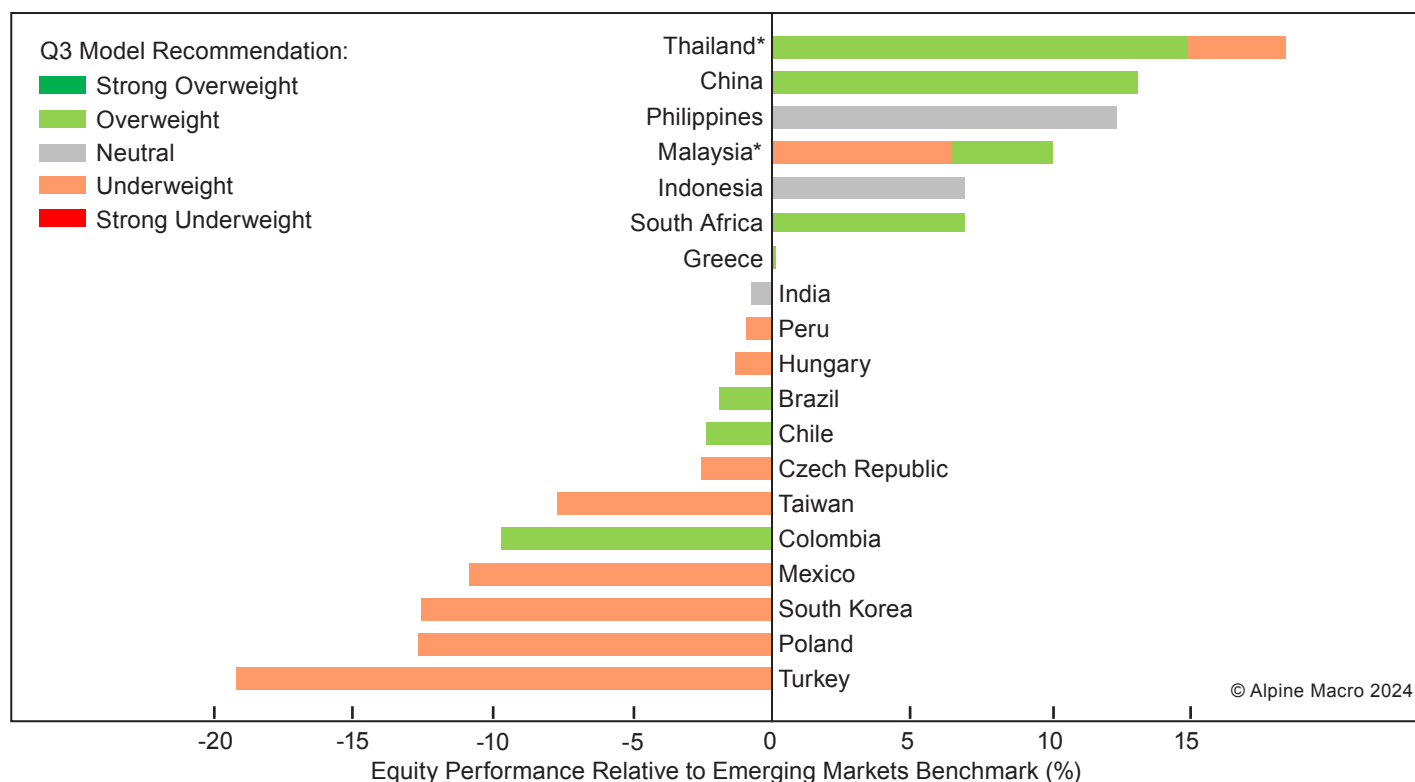


Chart 2 EM Country Equities Q3 Scorecard

*Positions on both countries were revised during Q3, 2024

Chart 2 shows the relative performance of various EM bourses against the benchmark over the past quarter. The model's positions in most major bourses have performed well, and it has significantly outperformed the EM benchmark. We adjusted our allocations for Malaysia and Thailand during the quarter: we overweighted Thailand until August 20th, then downgraded it to underweight following its sharp outperformance, while increasing our weighting in Malaysia. In mid-September, we upgraded both bourses within the broader ASEAN context.³ Both Malaysia and Thailand have been among the best performers in the past quarter.

³ Alpine Macro *EM & China Strategy* "ASEAN's Breakout, Mexico's Adjustment And China's Slump" (September 17, 2024).

Q4 Allocation

Table 1 summarizes the model's allocation for Q4. Many recommendations remain unchanged from the previous quarter, with a few notable adjustments.

Remain Overweight China

The model's overweight position in China has performed well, as it has significantly outperformed the EM benchmark in recent weeks. While Chinese stock prices may consolidate after such a sharp rise, we anticipate further upside and continue to overweight this market within EM.

China's Q3 GDP figures will likely be weak, but investors may overlook the poor data and begin focusing on whether Beijing's drastic policy shift



Table 1 EM Equity Country Allocation For Q4 2024

EM Equity Country Allocation			
Country	Q4 2024	Q3 2024	
Brazil	Overweight	Overweight	
Chile	Overweight	Overweight	
China	Overweight	Overweight	
Colombia	Overweight	Overweight	
Greece	Overweight	Overweight	
South Africa	Overweight	Overweight	
Indonesia	Overweight	Neutral	
Philippines	Overweight	Neutral	
Malaysia*	Overweight	U/	O
Thailand*	Overweight	U/	O
South Korea	Overweight	Underweight	
India	Underweight	Neutral	
Czech Republic	Underweight	Underweight	
Hungary	Underweight	Underweight	
Mexico	Underweight	Underweight	
Peru	Underweight	Underweight	
Poland	Underweight	Underweight	
Taiwan	Underweight	Underweight	
Turkey	Underweight	Underweight	

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*Positions on both countries were revised during Q3, 2024

will stimulate growth. We believe the Chinese economy should respond positively to the policy easing. **Contrary to many analysts who attribute China's slowdown to "structural imbalances," we view the growth issues as largely self-inflicted due to repeated policy missteps by Beijing. Correcting these mistakes and lifting self-imposed constraints should allow the economy to rebound.**

We will closely monitor the economic situation and policy developments in the coming weeks, but from a market perspective, Chinese stocks remain deeply depressed.

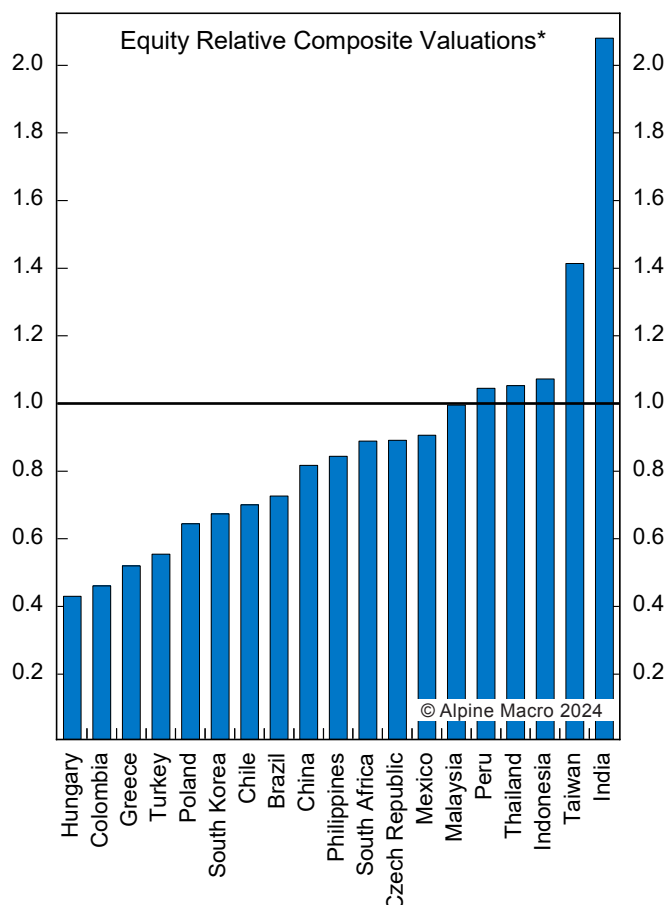
- Even after the recent surge, Chinese stocks are still among the cheapest in EM based on our composite valuation indicators ([Chart 3](#)). They

are trading at a fraction of the valuation multiples seen in high-flying markets like the U.S. and India.

- Years of poor performance have pushed Chinese stocks' relative performance versus the EM benchmark well below the long-term trend ([Chart 4](#)). Even after the sharp recent rally, their relative performance remains nearly one sigma below the trendline.
- Most investors likely missed the rally over the past two weeks. September fund manager surveys showed that shorting China was still among the most popular trades, and our recent conversations with investors suggest there is still widespread skepticism. If prices hold firm, sidelined money may be forced to jump in.



Chart 3 EM Country Equities:
A Valuation Perspective



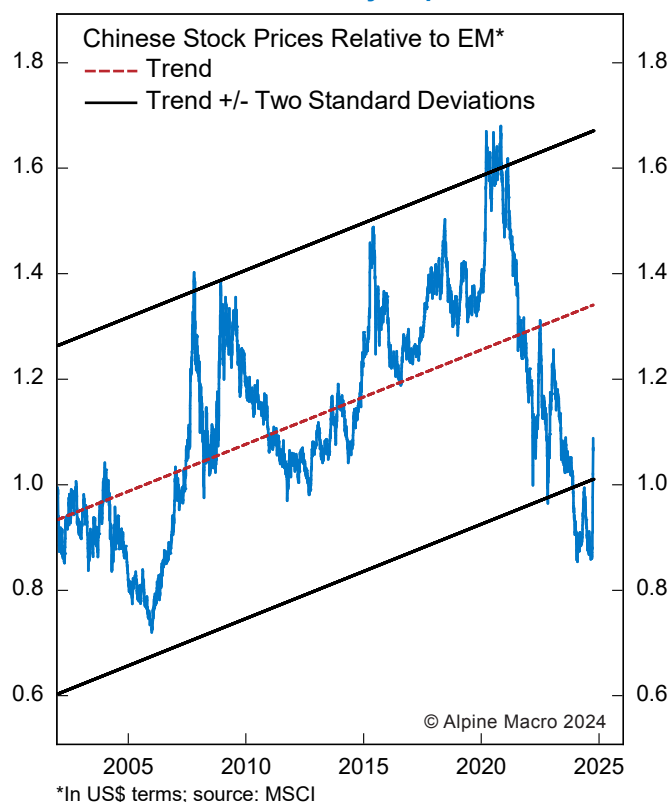
*Average of relative trailing PE, forward PE and PB ratios to EM benchmark; Alpine Macro calculations; source: MSCI

Bottom line: The positive rerating of Chinese stocks will continue. Remain overweight on China within an EM portfolio.

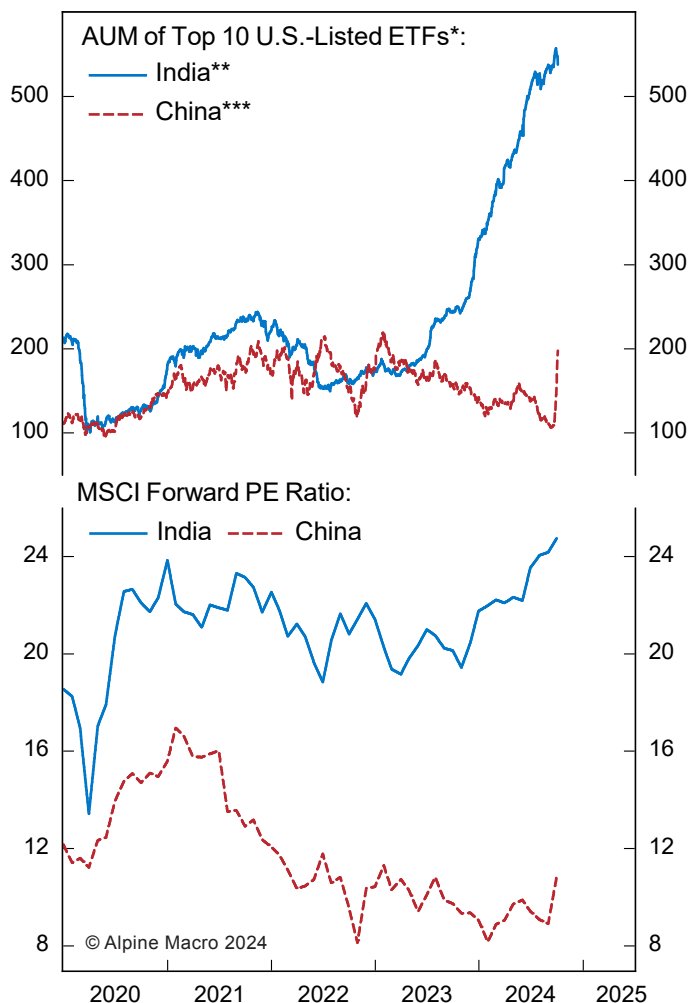
Downgrade India to "Underweight"

In Q3, we maintained a benchmark weight for Indian stocks within the EM portfolio, despite concerns about their overvaluation. This proved the right move, as Indian stocks slightly underperformed the EM benchmark – primarily due to China's dramatic outperformance – yet still outperformed EM ex-China. For Q4, we are downgrading India to "underweight."

Chart 4 Chinese Equities:
Still Extremely Depressed



- As one of the two largest components of the EM equity benchmark, India has been the default "anti-China" trade. China's poor growth and market performance in recent years led to steady capital inflows into Indian equities, but the tide is now shifting in the wake of Beijing's policy actions (Chart 5). The extreme valuation gap between the two EM giants will likely further facilitate fund flows in favor of China.
- Indian stocks' outperformance versus both the EM benchmark and EM ex-China has become extremely stretched compared to long-term trends (Chart 6). While Indian earnings have been stronger than their EM peers, most of the outperformance stems from relative multiple expansion. Indian equities remain the most expensive in EM, as shown in Chart 3.

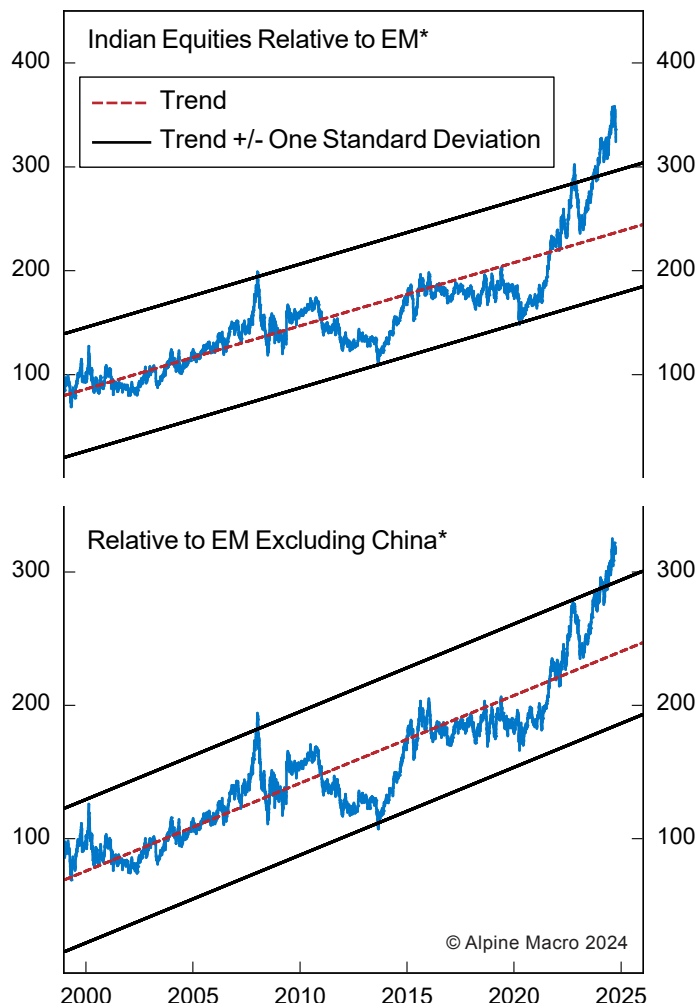
Chart 5 Favor China Over India

*Rebased to Mar 2020=100; source: Bloomberg Finance L.P.

**Includes INDIA, EPI, INDY, SMIN, FLIN, PIN, INCO, NIFTY, GLIN and INDL

***Includes MCHI, KWEB, FXI, ASHR, YINN, CQQQ, GXC, CXSE, CWEB and CNYA

- India's domestic growth is also starting to moderate, albeit from robust levels.⁴ Recent PMI numbers are still expanding but at a slower pace, and core industry production has contracted for the first time since the pandemic. Our India Business Cycle Indicator continues to slow (Chart 7), which likely signals weaker earnings

Chart 6 Indian Stocks: The Relative Bull Market Looks Stretched

*Rebased to Jan 2000=100

Source: MSCI

growth – another headwind for Indian equities from a relative perspective.

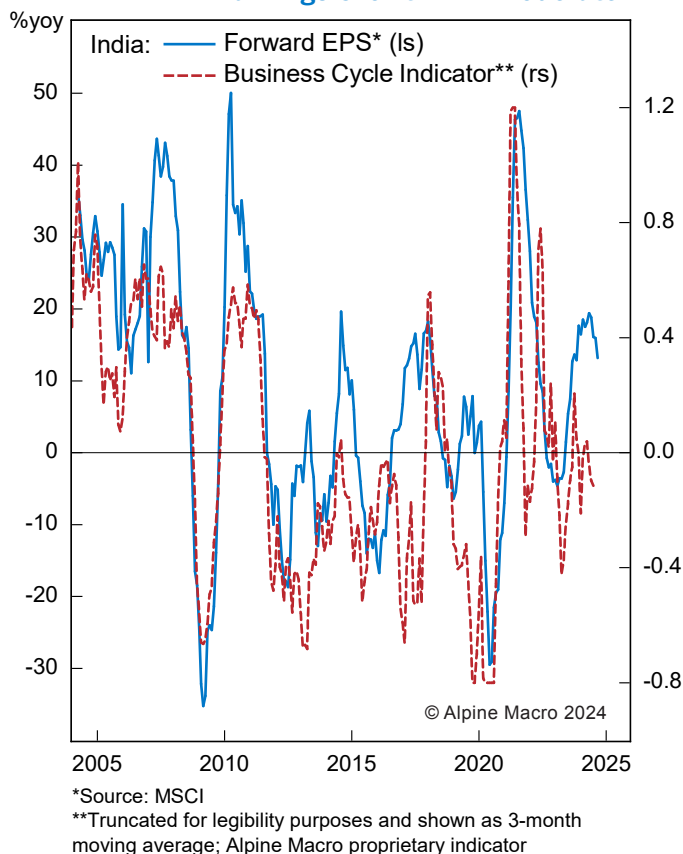
Upgrade Korea To "Overweight"

In Q3, the model's underweight on Korea proved effective, as the market was among the worst performers in EM. With a reduced weight in India, we are upgrading Korea to "overweight" for Q4.

⁴ Alpine Macro *EM & China Strategy* "India: Passing Cyclical Peak, How Much Downside?" (September 3, 2024).

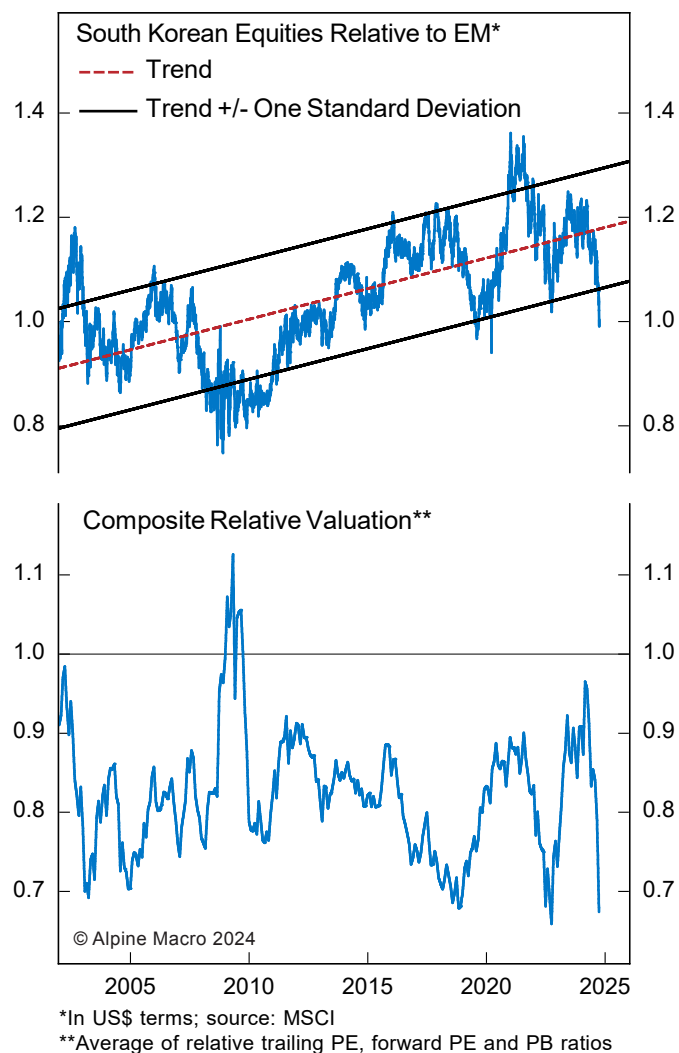


Chart 7 India: Earnings Growth Will Moderate



- Korean stocks have fallen to an "oversold" extreme following their sharp underperformance last quarter. Their relative performance against the EM benchmark is now one sigma below the long-term trendline, a level that historically typically triggers an upward mean reversion (**Chart 8**). At the very least, the risk of further downside is now significantly reduced.
- Korean stocks are among the cheapest both in EM and globally, as shown in **Chart 3** on page 4. They are trading at around a 30% discount to the EM benchmark, near historically low levels (**Chart 8**, bottom panel). Korean stocks are

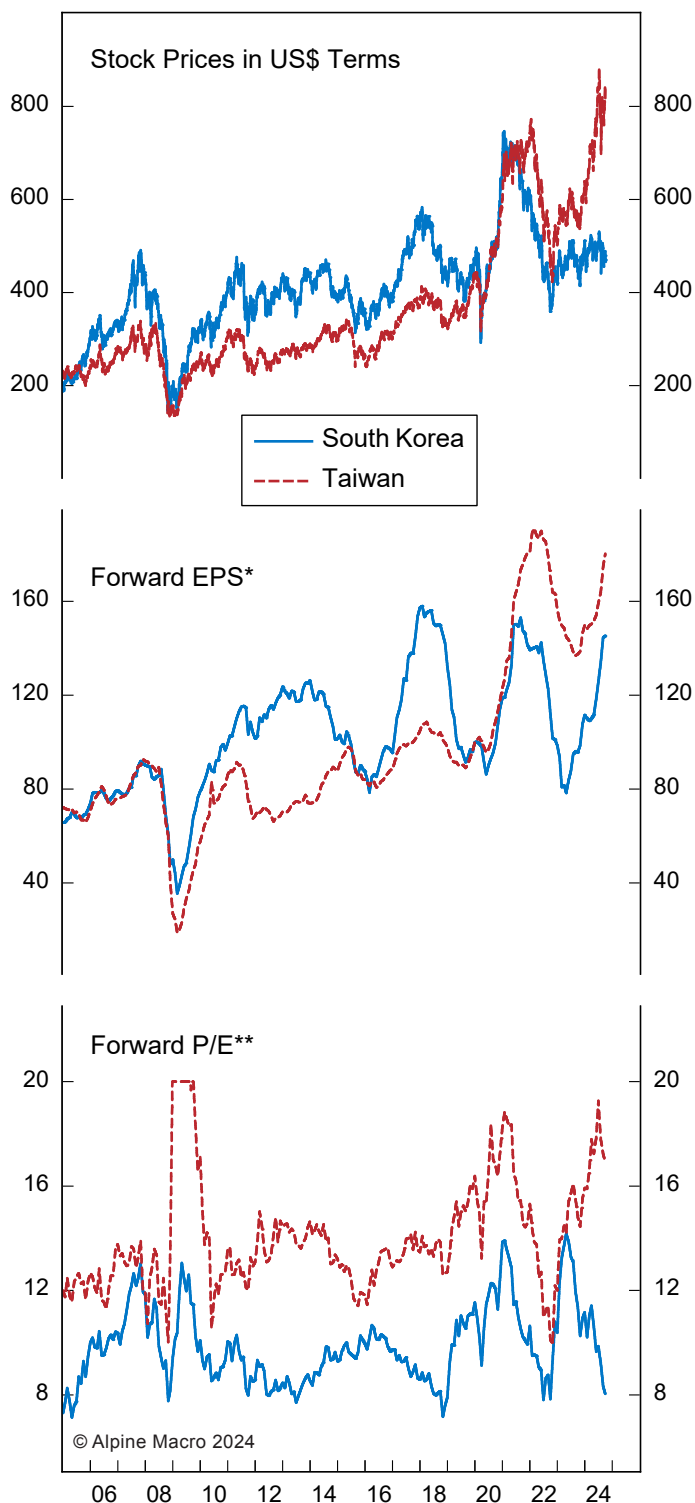
Chart 8 South Korea: The Relative Bear Market Is Overdone



currently priced at eight times forward earnings – less than half the multiple of their Taiwanese counterparts. **Chart 9** highlights the extreme price and valuation gaps between these two tech-heavy EM bourses.

- There is a growing case for domestic monetary easing in Korea due to a steep decline in inflation. Headline CPI has fallen to 1.6%, below the central bank's 2% medium-term target (**Chart 10**).

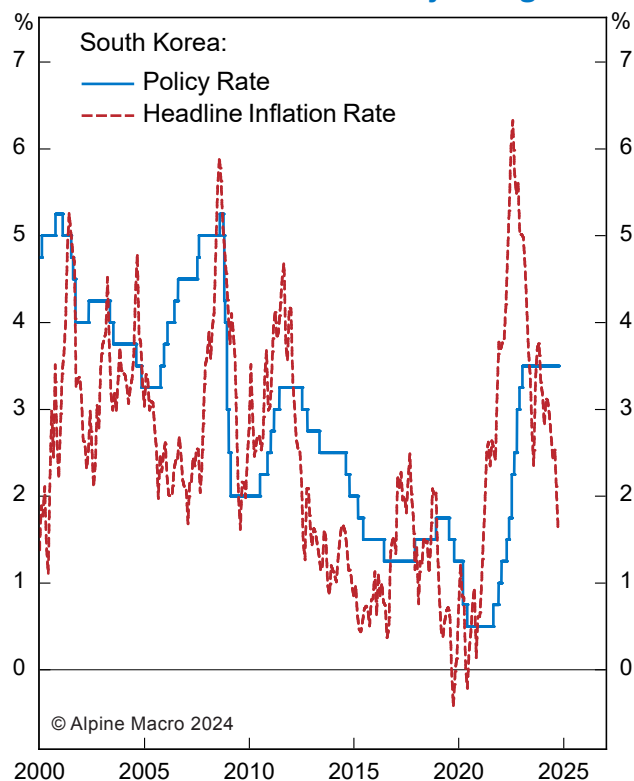


Chart 9 South Korea And Taiwan: Divergence Between Two Tech-Heavy Markets


*Both series are rebased to Jan 2020=100

**Taiwan's forward P/E is truncated at 20 for legibility purpose

Source: MSCI

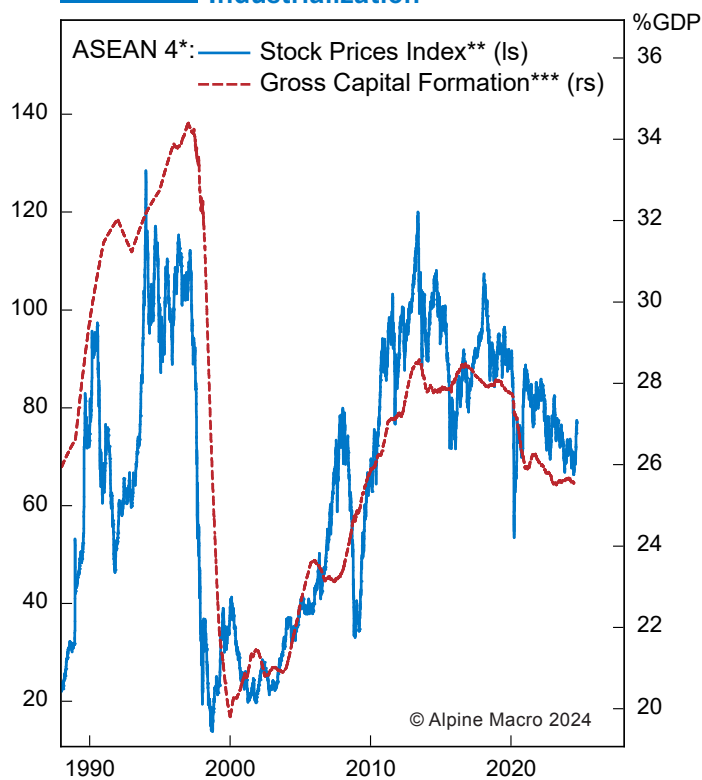
Chart 10 South Korea: The Case Of Imminent Monetary Easing


This increases the likelihood of an imminent rate cut, especially as the Fed has embarked on a new easing cycle. Such easing could help lift Korean equity multiples.

Bottom line: Korean stocks' underperformance has reached an oversold extreme. Upgrade to "overweight."

Overweight ASEAN Countries

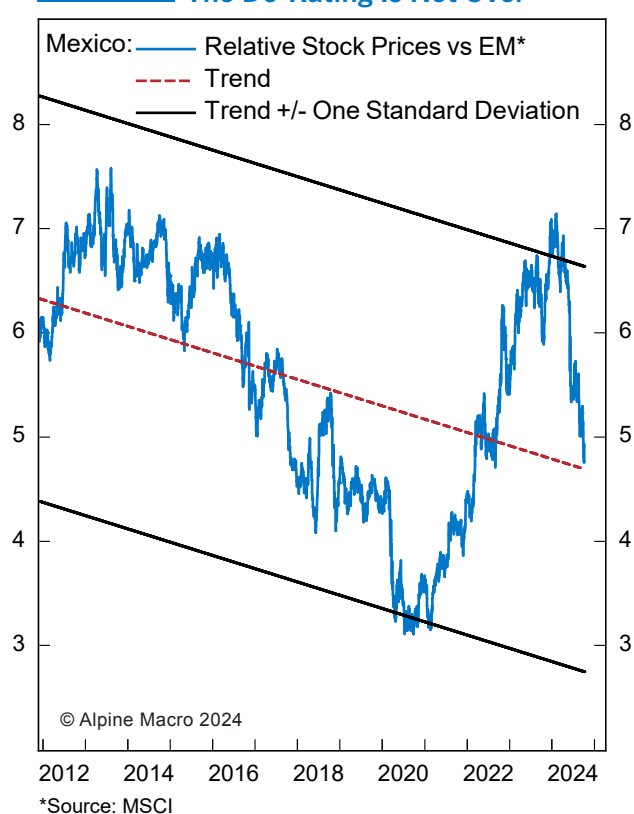
Since August, we have progressively recommended long equity positions in EM ASEAN bourses, including Malaysia, Thailand, Indonesia, and the Philippines. We expect further gains ahead and overweight these markets in an EM equity portfolio for Q4.

Chart 11 ASEAN: The Case Of Second-Wave Industrialization

*Includes Indonesia, Malaysia, Thailand and Philippines

**Market-cap weighted; rebased to Jan 1995=100

***Aggregate capital formation divided by aggregate GDP

Chart 12 Mexico: The De-Rating Is Not Over

Remain Underweight Mexico

Mexican stocks have significantly underperformed the EM benchmark in recent quarters. Our negative stance on this market has worked out, and the relative bear market is likely not over ([Chart 12](#)). We remain underweight Mexico for Q4.

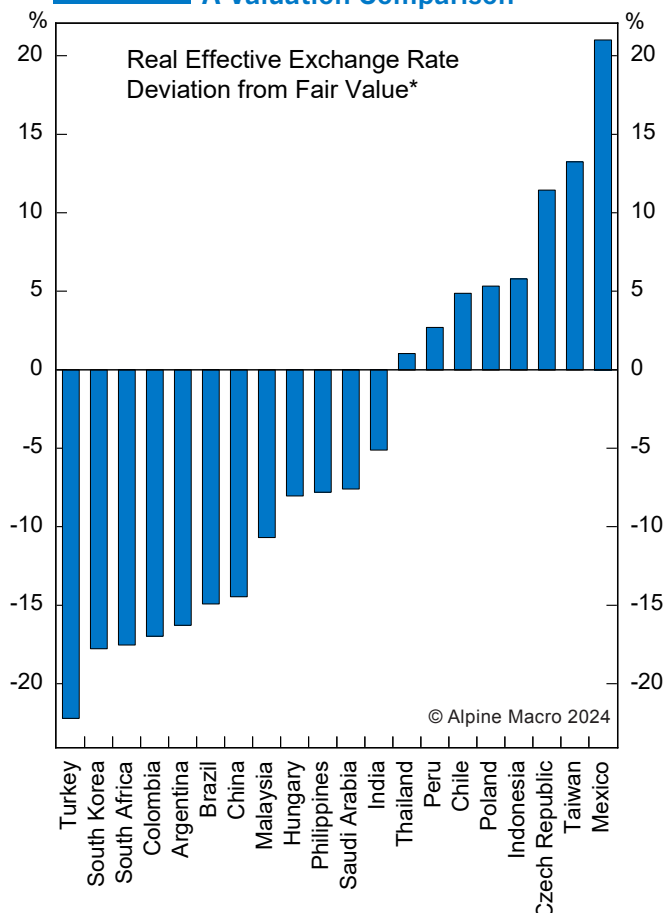
Our primary concern is the Mexican peso, which remains the most overvalued EM currency according to our models, despite its depreciation in recent months ([Chart 13](#)). Crucially, an expensive exchange rate undermines Mexico's ambition to become a "near-shoring" hotspot. Mexico's economy, particularly its manufacturing sector, has already slowed significantly, likely weighed down by the strong exchange rate.

The common theme for these countries is a developing capital spending boom driven by the global supply chain shift, as detailed in two recent reports.^{3,5} These economies, having been stagnant since the Asian Crisis, may experience a "second wave" of industrialization as manufacturing capacities relocate to these regions ([Chart 11](#)). This shift bodes well for their structural growth outlook and equity performance. While ASEAN stocks aren't significantly cheaper than the EM benchmark, most valuation indicators for these markets are at the lower end of their historical ranges.

5 Alpine Macro *EM & China Strategy* "Buy Malaysia: Riding On The Tech Boom" (August 20, 2024).

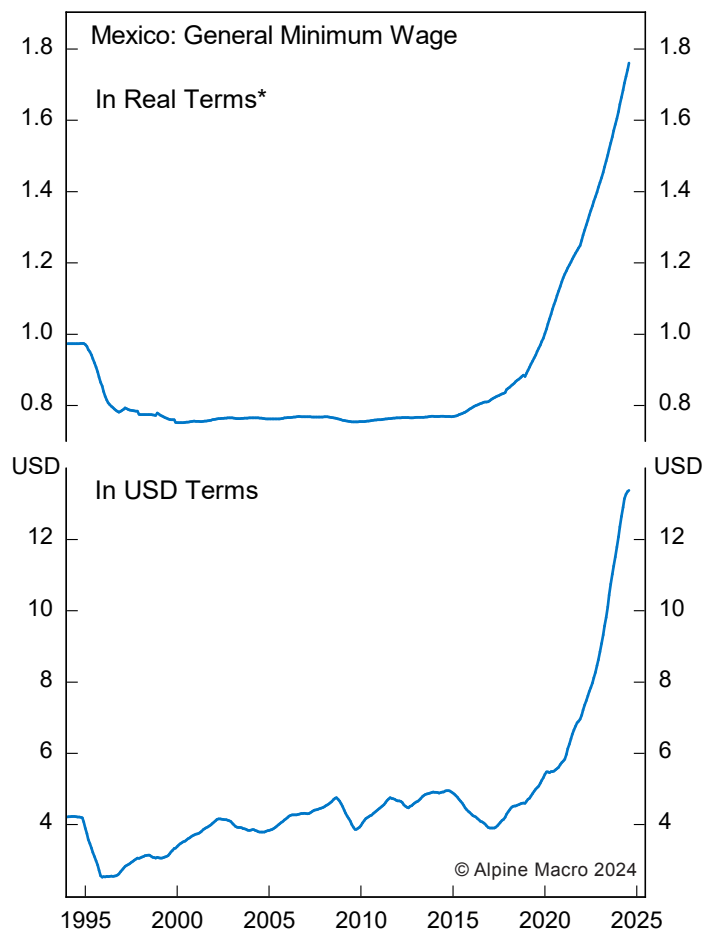


Chart 13 EM Currencies:
A Valuation Comparison



*Alpine Macro proprietary indicator

Chart 14 Mexico:
An Explosive Growth In Wages



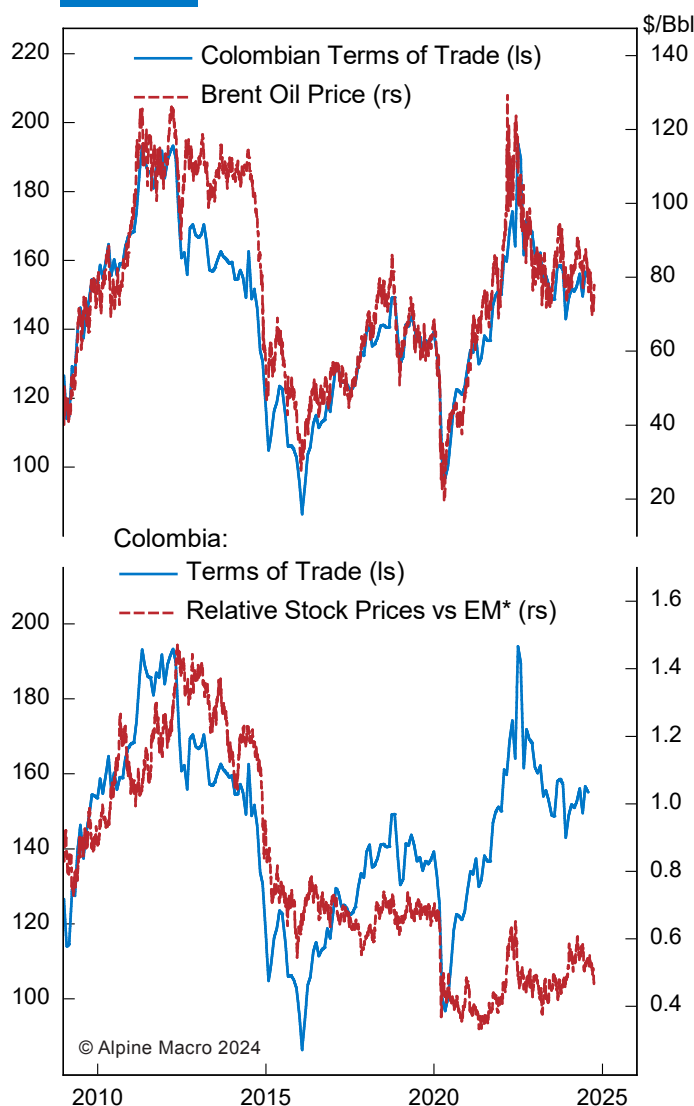
*Deflated by headline CPI

Note: Both series are shown as 12-month moving average

Compounding the issue, Mexico's left-wing government has dramatically increased minimum wages in recent years. Chart 14 shows the sharp rise in minimum wages – both in real terms and U.S. dollar terms – under former President Andrés Manuel López Obrador. The new administration, led by President Claudia Sheinbaum, has pledged to continue this trend, with a 12% minimum wage hike planned for next year and commitments to similar annual increases. These planned increases vastly outpace the current inflation rate, with headline and core CPI at 5% and 4%, respectively.

Without a significant rise in labor productivity, this rapid increase in real wages will further hamper economic growth, particularly in the manufacturing sector. This leaves currency depreciation as the only release valve to restore balance. On the other hand, if the MXN fails to depreciate further, corporate earnings will suffer, which is bad news for stock prices.

Bottom Line: Remain underweight on Mexican stocks.

Chart 15 Colombia As A Distressed Oil Play

Overweight Depressed Commodity Plays In Latin America

In contrast, the currencies of many of Mexico's Latin American neighbors are deeply undervalued ([Chart 13](#)), and their stocks are trading at much lower multiples. **We prefer markets like Brazil, Chile, and Colombia for commodity exposure.**

These beaten-down commodity plays stand to benefit if China's policy reflation boosts the

growth outlook and commodity demand. Additionally, the developing geopolitical crisis in the Middle East could lead to sudden crude oil supply disruptions, spiking oil prices and the broader commodity complex.⁶ These markets also serve as a hedge against geopolitical tail risks. For example, [Chart 15](#) shows oil prices are directly linked to Colombia's terms of trade, which in turn derives Colombian stocks' relative performance versus the EM benchmark.

EM Sector Allocation

Similar to our country allocation strategy, our EM equity sector allocation relies on a quant-driven process supported by our EM Equity Sector Allocation model, with input from our subjective assessments.

In the past quarter, our sector allocation model slightly outperformed the benchmark ([Chart 16](#)). Consumer Discretionary and Healthcare sectors, which the model overweighted, were the best performers. However, the overweight positions in Energy and Materials have not been as successful, as both sectors lagged.

For Q4, the model continues to overweight Consumer Discretionary and Healthcare, and is also upgrading Consumer Staples ([Table 2](#)). The relative performance of these three sectors versus the EM benchmark has been in a structural uptrend, with notable swings around a central tendency. In recent years, these sectors have massively lagged the EM benchmark, driving their relative

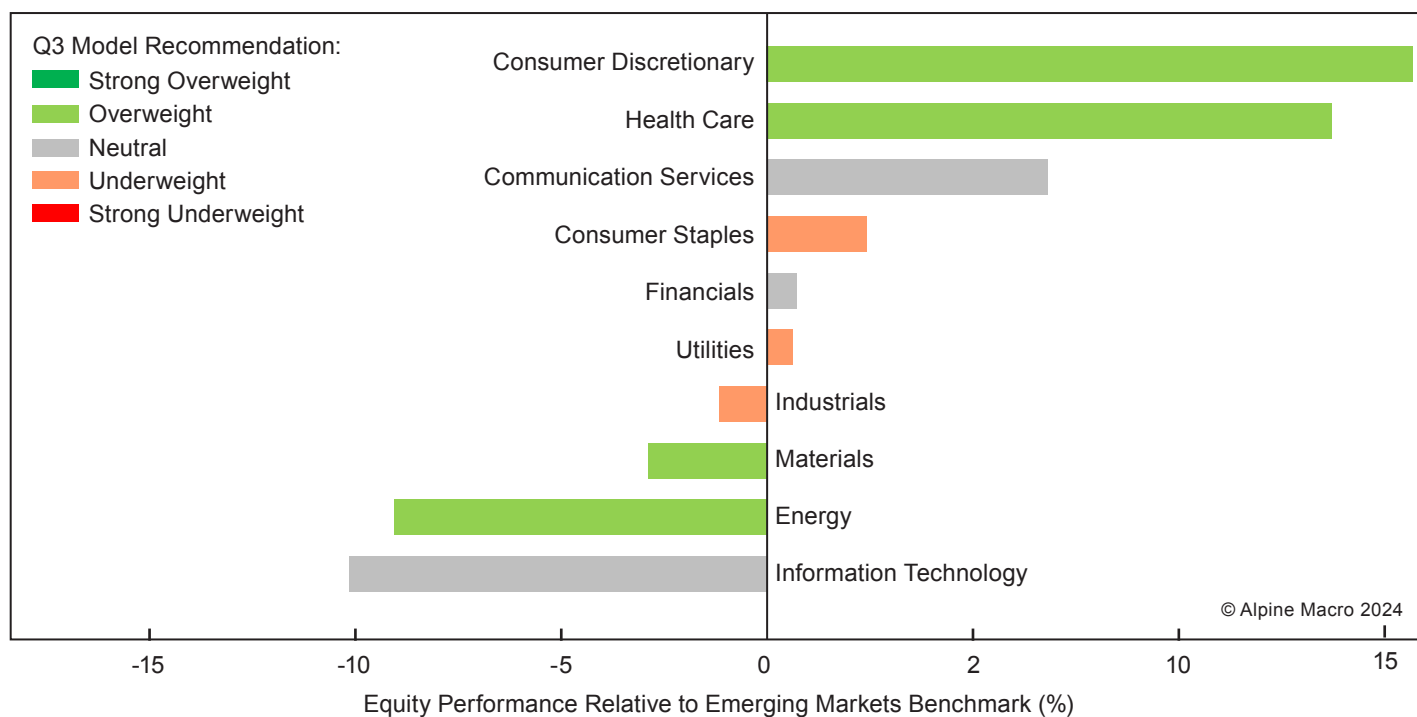
⁶ Alpine Macro *Global Strategy* "You Are Only As Good As Your Last Call" (October 7, 2024).



Table 2 EM Equity Sector Allocation For Q4 2024

EM Equity Sector Allocation		
Sector	Q4 2024	Q3 2024
Materials	Overweight	Overweight
Health Care	Overweight	Overweight
Consumer Discretionary	Overweight	Overweight
Consumer Staples	Overweight	Underweight
Energy	Neutral	Overweight
Communication Services	Neutral	Neutral
Information Technology	Neutral	Neutral
Financials	Neutral	Neutral
Industrials	Underweight	Underweight
Utilities	Underweight	Underweight

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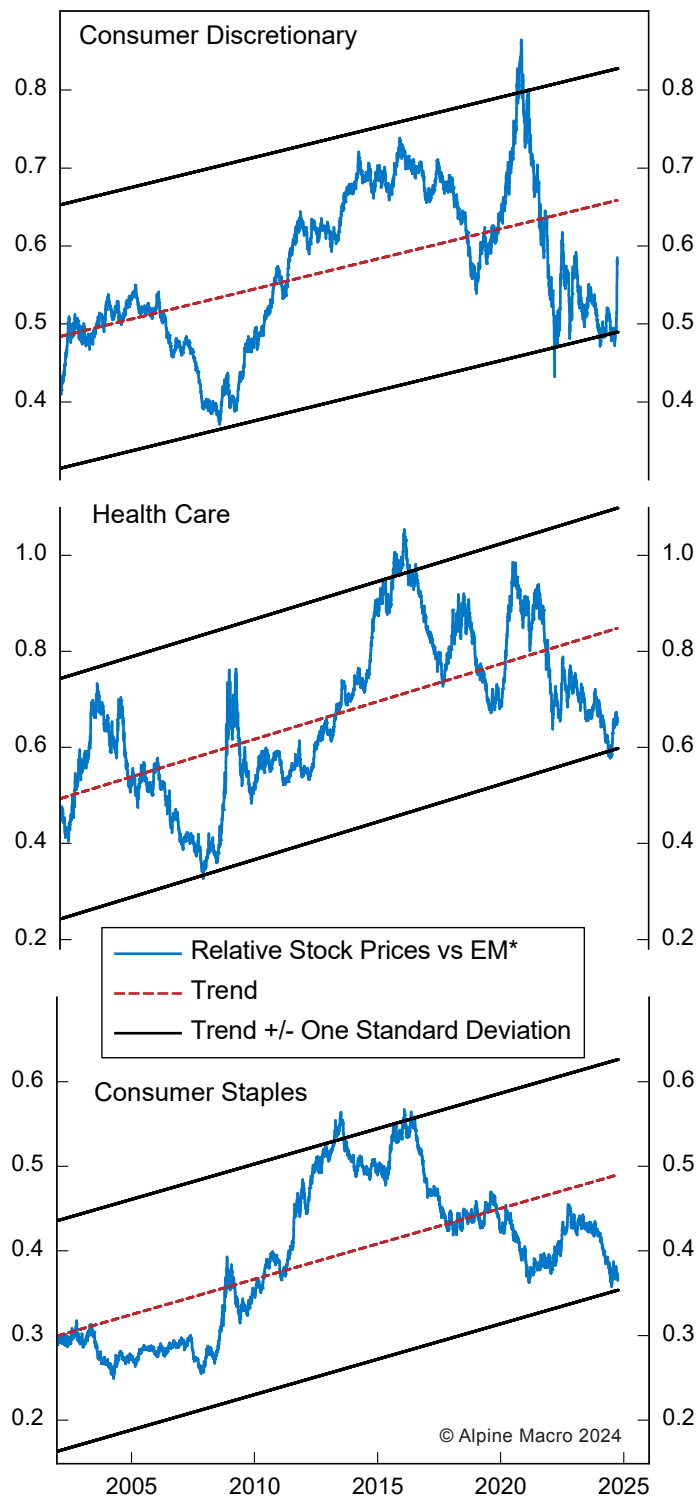
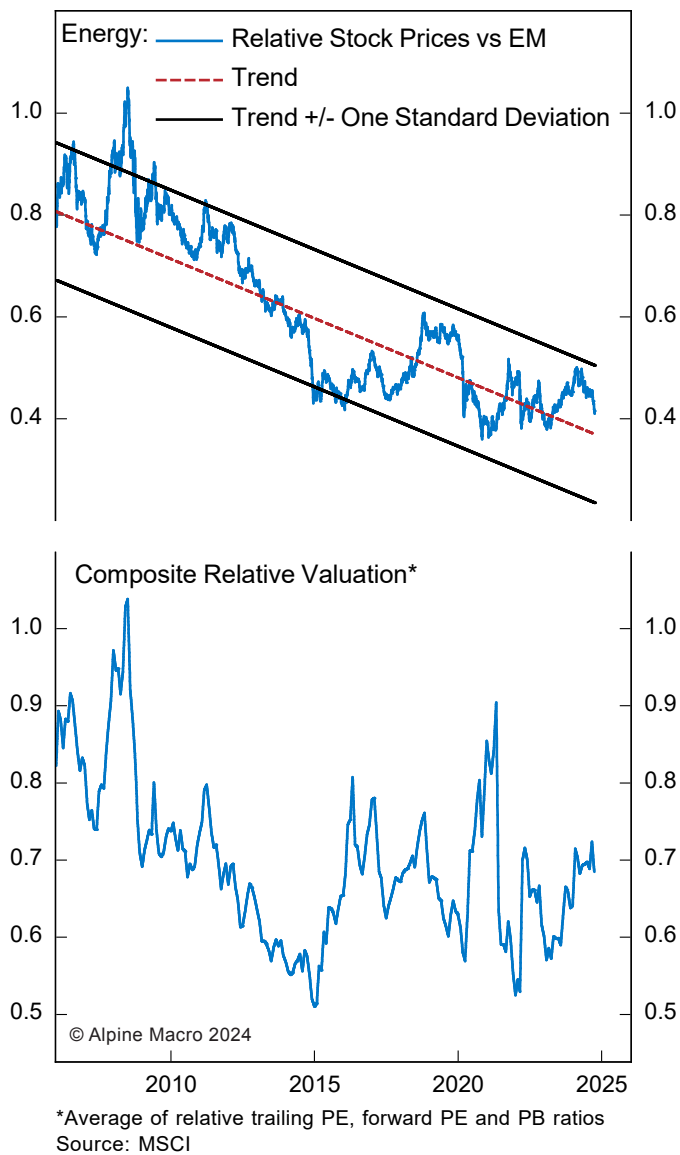
Chart 16 EM Sector Equities Q3 Scorecard

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performance to deeply oversold levels, which typically lead to a reversal ([Chart 17](#)). Consumer Discretionary and Healthcare stocks have already begun to recover, and Consumer Staples are nearing such levels, justifying an upgrade.

Meanwhile, we are downgrading the Energy sector to neutral to accommodate the increased weighting for Consumer Staples. The technical outlook for the Energy sector, both in absolute terms and relative to the EM benchmark, looks weak, and valuation indicators are no longer as compelling ([Chart 18](#)).



Chart 17 Long-Term Mean Reversion:
Upgrade Consumer Staples**Chart 18** Downgrade Energy

We are hesitant to move it to underweight due to brewing geopolitical risks in the Middle East.

Yan Wang, CFA

Chief Emerging Markets & China Strategist



Investment Recommendations

Strategic Positions (6 - 12 months)

Recommendations	Open Date	Closing Date	Total P&L	Notes
Long Colombian 10-year Government Bond, Currency Unhedged	11/21/2023		10.2%	Long Colombian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long MSCI Greece Equity Index	11/21/2023		12.1%	Long MSCI Greece Equity Index in US\$ terms; stop point at -10%.
Long Indian 10-year Government Bond, Currency Unhedged	06/04/2024		3.3%	Long Indian 10-year Government Bond, Currency Unhedged; stop point at -10%.
Long Malaysian Equities, Currency Unhedged	08/20/2024		3.1%	Long MSCI Malaysia Equity Index in US\$ terms; stop point at -10%.
Long ASEAN Equities, Currency Unhedged	09/17/2024		-0.8%	Long MSCI EM ASEAN Index in US\$ terms; stop point at -10%.
Long BRL/MXN	09/23/2024		0.7%	Long Brazilian <i>Real</i> versus Mexican Peso; stop point at -10%.

Tactical Investment Positions (3 - 6 months)

Recommendations	Open Date	Closing Date	Total P&L	Notes
Short CZK/HUF	06/05/2023		3.5%	Short Czech Koruna versus Hungarian Forint; rolling stop point at -5%, or -2.8% from current level.
Long MSCI China Equity Index	02/20/2024		43.5%	Long MSCI China Equity Index in US\$ terms; rolling stop point at -10%, or -10% from current level.
Short COP/CLP	03/05/2024		8.1%	Short Colombian Peso versus Chilean Peso; rolling stop point at -5%, or -2% from current level.
Long ZAR/USD	09/23/2024		-0.7%	Long South African Rand versus U.S. Dollar; stop point at -10%.
Long CSI 300 Index	02/20/2024*		14.3%	Long China A-shares Index in US\$ terms; stop point at -10%. *Trade opened on 20 Feb, 2024, closed on 13 Sep, 2024 and reopened on 24 Sep, 2024.

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

EM Equity Sector Allocation	
Strong Overweight	Overweight
	Materials
	Health Care
	Consumer Discretionary
	Consumer Staples
Neutral	
Energy	
Communication Services	
Information Technology	
Financials	
Strong Underweight	Underweight
	Industrials
	Utilities

EM Local-Currency Government Bond Allocation		
Overweight	Neutral	Underweight
Indonesia	Poland	Czech Republic
Peru	Hungary	Thailand
Brazil	South Korea	China
Colombia	Malaysia	Taiwan
Chile	Philippines	Turkey
India	South Africa	
	Mexico	



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