



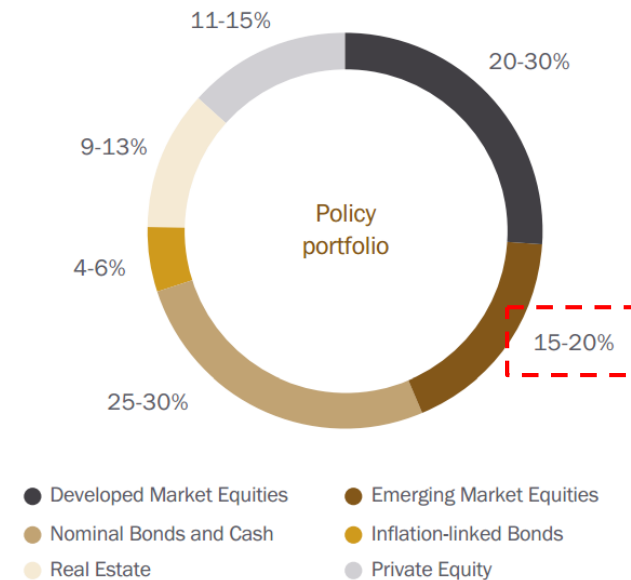
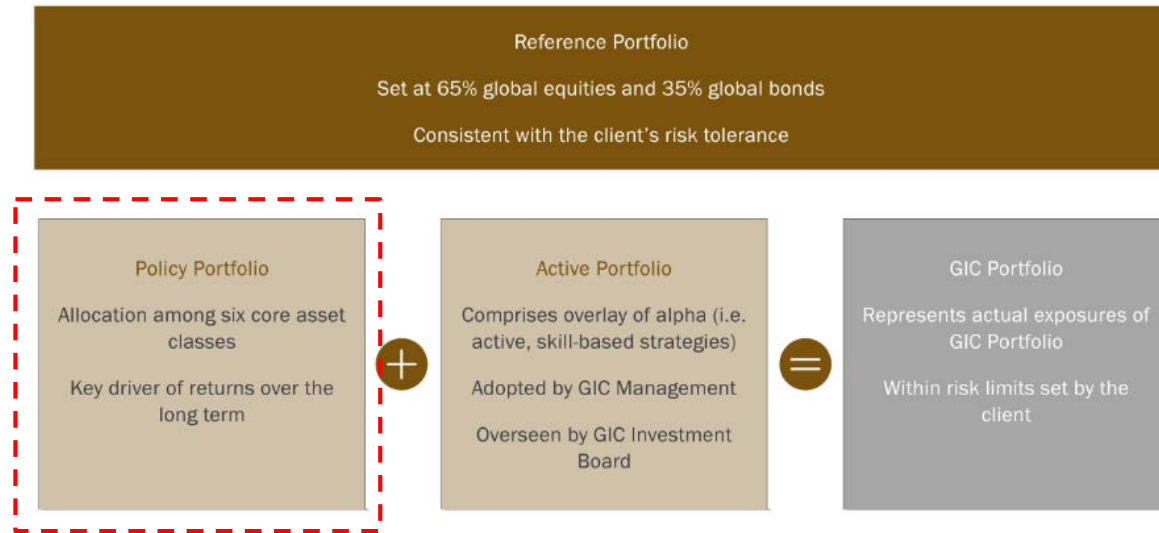
Emerging Markets: An Asset Owner's Perspective

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The Role of EM in the GIC Portfolio

- GIC's Policy Portfolio is constructed to achieve good long-term real returns whilst adhering to our client's risk limits.** It is expected to outperform the Reference Portfolio – representing our client's desired risk tolerance – over the long-term.
- GIC's allocation to EM equities in the Policy Portfolio** reflects the view that this asset class will benefit from sustained structural improvements in these countries and contribute positively to the Portfolio's real returns in the long-term. **This assessment remains unchanged** despite recent underperformance of EM equities relative to developed market (DM) equities.
- GIC also invests in EM via other asset classes** (Bonds, Private Equity, Real Estate) and has indirect exposures through DM-domiciled investments that derive revenues from EM markets.



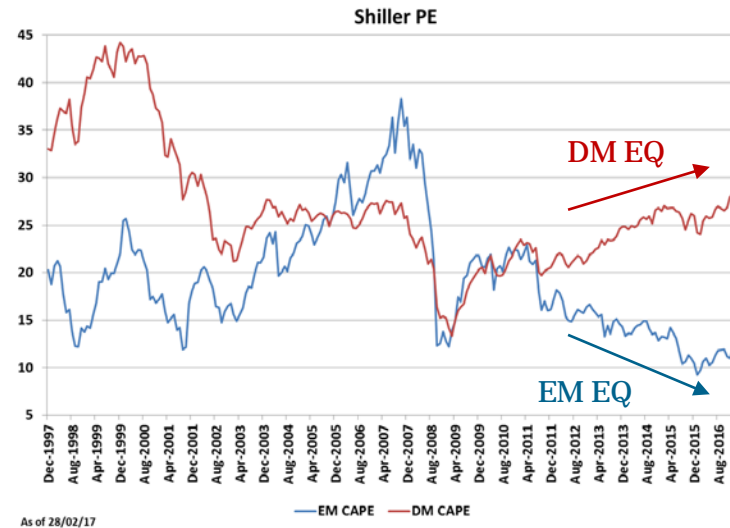
Source: GIC Annual Report 2015/2016

A Long(er)-Term Perspective on EM

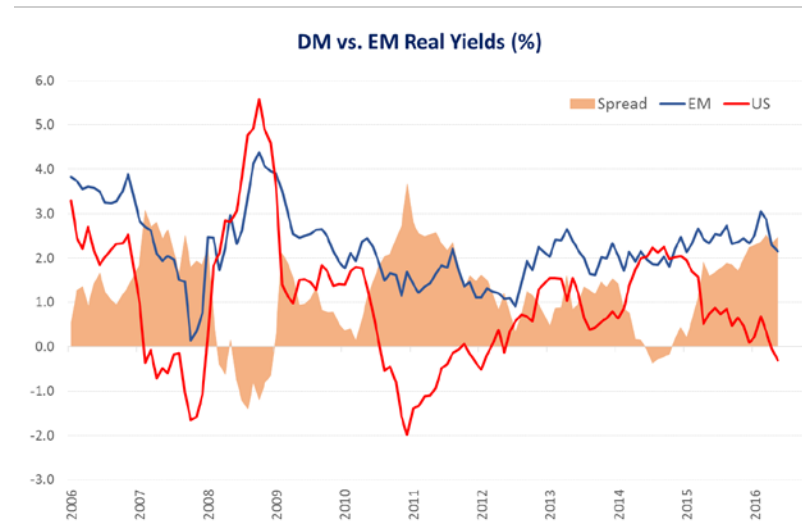
- 1. Economic convergence and thematic trends remain intact.** We expect EM to enjoy a sustainable growth advantage over developed economies, underpinned by structural factors such as demographics, capital formation and factor market development. Trends such as the emerging middle-class consumer, demand for healthcare, rising role of online services/e-commerce, urbanisation and infrastructure needs are durable and investable themes.
- 2. Upside from sound policy choices and reforms.** Despite significant improvements over the years, we still see ample scope to boost macroeconomic performance and potential through good policies and well-designed reforms that are targeted at reducing economic vulnerabilities, raising productivity and strengthening institutional frameworks.
- 3. Need for capital and inefficient markets create opportunities.** At the macro level, EM offers a risk premium partly because of a deficit of savings versus investment needs, but opportunities also exist at the micro level due to under-developed or less accessible capital markets. To be prepared to take advantage, we are deepening our specialist knowledge and expertise in key EM markets and stepping up our partnership and engagement efforts on the ground.
- 4. But tailwinds are weaker.** Global trade and capital flows have likely peaked as trade integration has reached high levels and tighter regulation favours domestically-funded banking systems. Elevated debt levels are likely to constrain growth, even as credit penetration should continue to broaden. Positive externalities and gains from structural shifts (e.g. China's entry into WTO, trade liberalization) have less potential going forward.

EM Valuations are Cheap

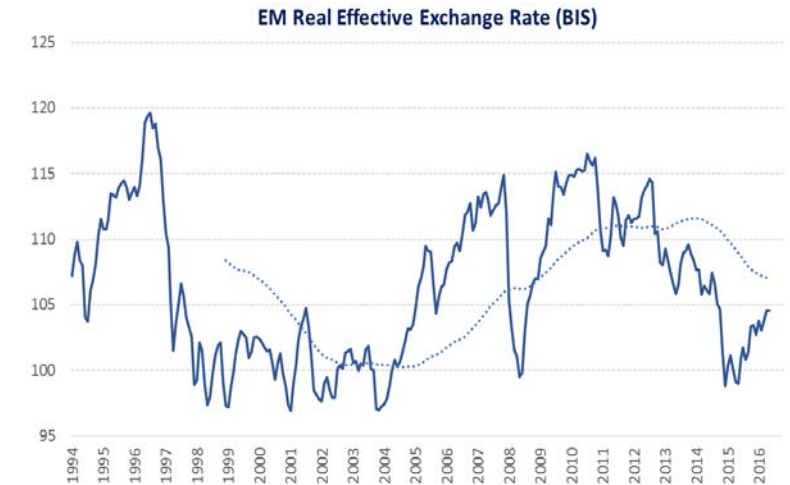
EM Equity valuations have de-rated substantially in relative and absolute terms.



EM Bonds (LC) offer an attractive yield pick-up on an inflation-adjusted basis.



EM Currencies remain inexpensive despite improving external balances.



EM assets at current valuations offer an **attractive margin of safety** for long-term investors.

The Impact of Political Trends on EM

Nationalism*

- Disappointment over economic outcomes from globalization
- Displacement of jobs due to competition and disruptive technologies
- Perception of lack of control over domestic policies
- Political pressure for short-term fixes

Protectionist Policies

- Tariffs; import quotas; administrative controls
- Directed subsidies
- Border adjustment tax
- Renegotiation of trade agreements
- Immigration controls

Geopolitical Tensions

- Increased polarization and zero-sum approach to foreign/trade policy
- Greater likelihood of retaliation and escalation
- Higher risks of a systemic event causing a deflationary growth shock

Economic Impact

- Trade and supply-chain disruptions
- Higher inflation and a more hawkish Fed
- Lower business confidence and reduced investments
- Adverse impact on EM growth and capital flows to EM

**EM countries are by no means immune to nationalism/populism even as the recent trend is most apparent in developed economies*

The EM Landscape and Our Response

Outlook

- **Fundamental upside** from structural convergence trends and reform gains
- **Attractive valuations** offer good forward-looking returns
- **Global investors are under-exposed to EM assets** relative to their economic weight or capital market size

Challenges

- **Macro tailwinds are weaker** than before
- **Protectionist policies** pose a risk for trade and capital flows to EM
- Approaching an **inflection point for easy monetary policies** in DM
- **Barriers to entry** remain significant

Response

- Take a **differentiated perspective** towards EM
- Focus on **robust portfolio construction** and a **value-oriented** investment process
- Substitute EM beta with **bottoms-up alpha investments**
- **Seek opportunities in DM companies** that offer good exposure to EM structural trends