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Q&A-Global trade to play smaller role in emerging market growth: Charles Wilson, Thornburg Investment Management

Emerging market growth is shifting away from international trade and investment to being driven by domestic consumption, **Charles Wilson, portfolio manager of the Developing Worlds Fund and managing director at Thornburg Investment Management,** told the Reuters Global Markets Forum on Wednesday, February 3.

"Emerging markets have been in transition from the old growth model to the new growth model driven more by domestic consumption which is more insulated from global trading conflicts [and] concerns by its nature," Wilson said.

He added that a shift in investment from China to other emerging Asian economies such as India and Vietnam, driven mainly by lower labor costs, will continue and lead to more investment in infrastructure and logistics.

Following are edited excerpts from the conversation:

Q: Could you run us through the thesis for the Developing World Fund, and the specific geographies and asset classes you see best poised to benefit from the post-pandemic recovery?

A: The Thornburg Developing World Fund is an Emerging Market (EM) equity fund that seeks to deliver long term attractive returns through a concentrated portfolio balanced across styles -- value and growth. We believe that long term opportunities in emerging markets are also coupled with periods of volatility, so we build a portfolio of the strongest businesses in emerging markets.

As far as asset classes that we like, we believe that EM is benefitting from both cyclical and structural tailwinds right now. On the structural side, the emerging market middle class has tripled in size over the last decade and is over 2 billion people. This is large enough to be an independent growth driver which can take the reins from investment and global trade which was the old growth model. The cyclical tailwinds will be driven by the synchronized global recovery, easy monetary policy we see everywhere, and the prospect of a soft dollar which should support EM FX.

We actually are bullish about India, Indonesia, and Latin America. We think those markets still offer attractive valuations due to uncertainty about the post-virus recovery combined with great long term growth prospects.

Q: To your point on trade being part of the old growth model, would you say trade conflicts -- such as the U.S. - China tensions of the last few years -- will play a smaller role in future EM growth?

A: Yes. Global trade and fixed asset investment have been sluggish for most of the last decade. I would say EM has been in transition from the old growth model to the new growth model driven more by domestic consumption which is more insulated from global trading conflicts/concerns by its nature. The contribution of net exports to Chinese gross domestic product (GDP) growth has been near zero for almost 5 years for example.

Q: Do trade tensions between the United States and China begin subsiding under a Biden administration? How much as this played into your view on Chinese markets?

A: I think our view is that the relationship between China and the U.S. has permanently changed. Both sides of the aisle in the U.S. government now recognize the importance of protecting U.S. interests with respect to our relationship with China.

With that said, we believe that the U.S. and China can still have a productive partnership. We also expect the Biden administration to have more direct and clear communication making it easier for both sides and market participants to incorporate policy shifts into forecasts.

Q: What expectations do you have for foreign investment in Asia in 2021, particularly member countries of the Regional Comprehensive Economic Partnership (RCEP) agreement?

A: With the shift of the EM growth model more towards domestic consumption we have naturally shifted our focus there as well. That limits the amount of exposure we have to trade related issues

We have seen a shift in investment away from China towards the rest of the region occurring for some time. We think this has more to do with better labor costs elsewhere rather than trade agreements or policy changes. We would expect this trend to continue as companies focus on optimizing labor costs. It's also important to note that about 80% of the global middle class growth over the next decade will come from Asian countries. [That's] also supportive of investment.

Q: Which countries will be the biggest beneficiaries from that shift?

A: So far, it has been countries in Southeast Asia with low cost labor such as Vietnam or Cambodia. We own a company in China that is the largest garment manufacturer in the world. They have been shifting production there for the last 5 years. But we would expect India and Indonesia to see more production over the next few years. They are investing heavily in infrastructure to support their production capabilities.

Q: Back to China for a moment, are you concerned about the recent U.S. bans on investing in certain Chinese companies?

A: That is part of the changing relationship with China I referred to earlier. The US is in the process of setting new guidelines and expectations for both sides. I don't like to see such direct measures when we could negotiate behind the scenes and allow more policy flexibility.

But - we don't hold any companies on the list and would be reluctant to buy them. You could say the policy goal was achieved.

Q: As RCEP is intricately linked to ease of trade and investment across the member countries, what sort of impact do you see on infrastructure development and foreign investment?

A: One of the biggest issues that countries like Indonesia and India face is logistics. They might have abundant low cost and some cases low cost skilled labor but they can't lead in terms of trade due to the cost of logistics. We think this will continue to attract investment from overseas with the goal of solving this challenge.