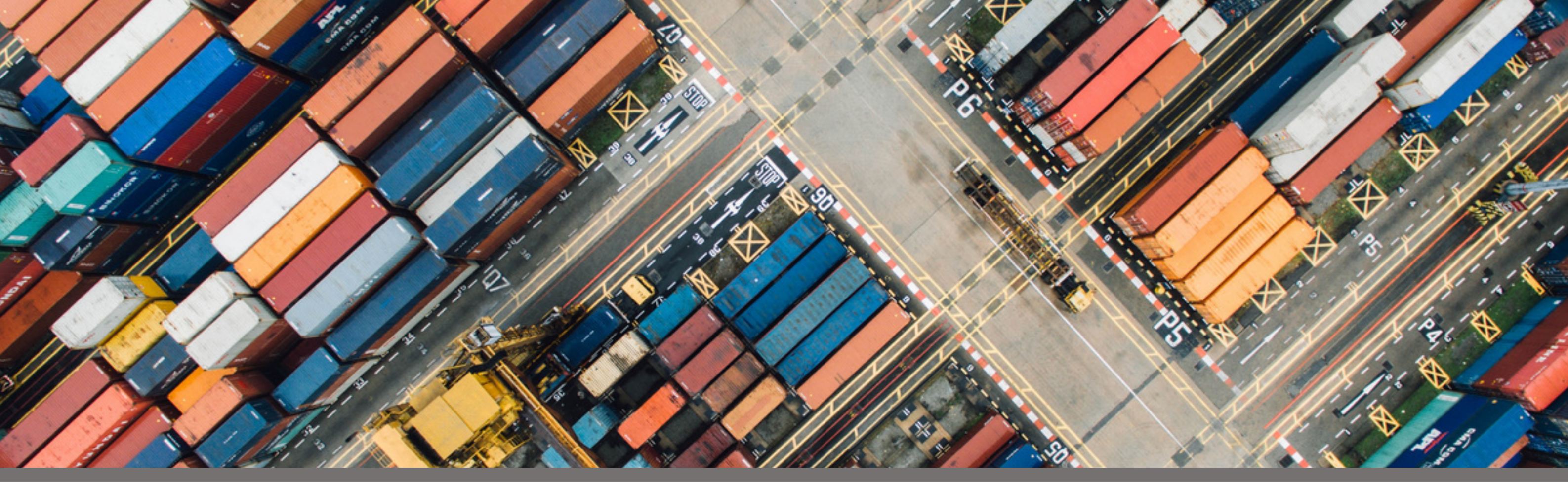


FUND LAUNCHED
2005

FUNDS UNDER MANAGEMENT
£545.3
MILLION

NET ASSET VALUE PER SHARE
347.8%
SINCE INCEPTION*

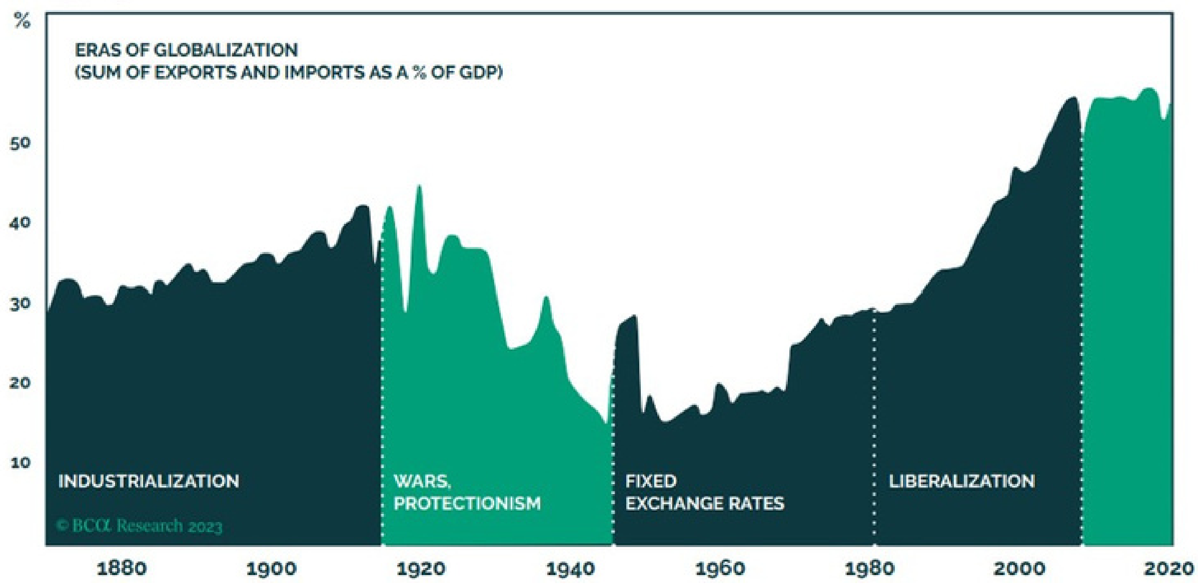
UTILICO
Emerging Markets Trust plc

Globalisation, geopolitics, and EM investing in a multi-polar world

July 2023

"Trade wars are good, and easy to win." With this tweet in March 2018, US President Donald Trump announced the end of half a century of liberalisation. Global trade as a percentage of total GDP had expanded from 25% in 1970, peaking at over 60% in 2008 before the Great Financial Crisis hit and activity settled in the 50-60% range.[1] But the message was now clear: globalisation – the integration of economies around the world through the free movement of goods, services and capital – is over. Protectionism is the new order, and we face a world of trade barriers, export controls, and economic conflict.

Hypo-globalisation Will Persist



Source: PIIIE, Jorda-Schularick-Taylor Macrohistory Database, Penn World Data (10.0), World Bank, and IMF Staff Calculations.

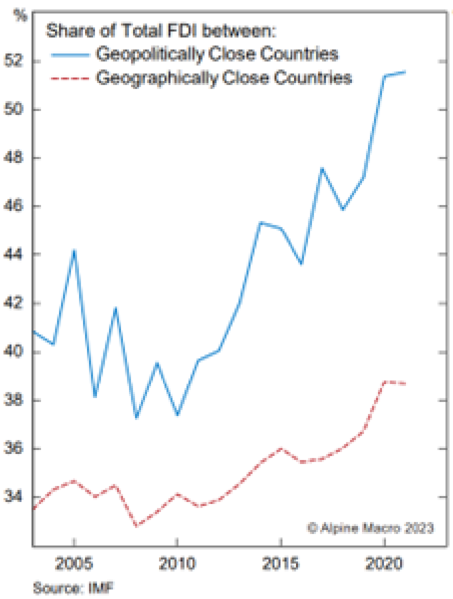
Widening trade deficits, intellectual property rights and the loss of jobs are the rallying cries for protectionism. But it is evident that geopolitics is also a strong factor. The emergence of China as a global superpower is challenging US dominance, and power is shifting from the West to the East. We are now living in a multi-polar world where economic power is being flexed in high stakes games across the globe. Taiwan, a democratic territory with strong economic ties to the US, epitomises the clash between Western and Eastern orthodoxy, as President Xi seeks to reunify it with mainland China. Military activity around Taiwan and the South China Sea has intensified. Economic battle lines are being drawn, most notably with the recent US ban on advanced semiconductor microchip exports from Taiwan into China.

Near- and Friend-shoring

The fallout from a multi-polar world is that governments and political blocs must re-evaluate existing relationships, and are pressured to "take sides". But this is no easy task for countries like Germany whose largest trading partner is China, but who are philosophically more aligned with US democratic doctrine and maintain Western military alliances, or those in the Asian sphere of influence which are integrated into manufacturing lines and trade heavily with both parties, like Vietnam. Events, most notably Russia's invasion of Ukraine, compound the need to reassess supply lines, focusing attention on food and energy security, as well as access to critical goods and materials.

All this has led to a significant change in foreign investment flows and trade policy, and the advent of "nearshoring" and "friendshoring" – manufacturing and sourcing components and raw materials from countries which are in geographic proximity, and allies with shared values. Over the past decade, these have been steadily increasing, especially friendshoring where foreign direct investment (FDI) among geopolitically close countries is up by a quarter and now accounts for over half of FDI.

Share of Total FDI



Source: IMF.

Share of US Goods Imports

Source: Alpine Macro, 2023.

Many major companies are driving these changes by diversifying their manufacturing base. For example, last year technology giant Apple announced that it is reducing its reliance on China, and plans to manufacture 25% of all iPhones in India, and 20% of all iPads and Apple Watches in Vietnam by 2025.

In one of the most prominent responses to supply chain security concerns, the US Inflation Reduction Act of 2022 (IRA) was signed into law in August 2022. This piece of legislation is expected to direct over $1 trillion of Federal funding to clean energy, through a mix of tax incentives, grants and loan guarantees. In effect, the US government is subsidising domestic manufacturing to try and make it more competitive by strengthening supply chains, whilst improving energy efficiency through greater energy security. Having raised the bar for cheaper foreign imports through trade tariffs, the IRA gives domestic businesses a further advantage.

Significantly, the IRA incentives are applicable to US free trade partners. These include Mexico and Canada, which are both geopolitically and geographically aligned. Mexico is a key beneficiary of nearshoring, offering the US a cost effective labour pool on its doorstep. It is notable that Tesla recently announced plans to build a new car manufacturing facility in Mexico, following in the footsteps of Ford which already produces Electric Vehicles in the country.

EM investing in a multi-polar world
As the geopolitical landscape shifts, so too does the flow of trade and investment. For Emerging Markets investors such as Utilico Emerging Markets, understanding the potential implications of these flows will be crucial for successful long-term investing:

- China will look to dominate the Asian sphere of influence and prioritise domestic stability and security concerns. State-Owned Entities will continue to be used to promote policy over economic returns, while the private sector endures greater government supervision. FDI will trail ASEAN neighbours, and local stock markets suffer outflows as US/EU pension funds pull out. Taiwan remains a stumbling block for Sino-US relations with potential to escalate rapidly.

- In Asia, Vietnam and India are likely to be the most significant beneficiaries of friendshoring, attracting greater FDI and bolstering long-term economic activity. Populations will see an acceleration in socio-economic development as the labour force upskills, helping lift people out of poverty and into the middle class.

- In Latin America, Mexico is the obvious winner from US nearshoring, and will become ever more integrated into the US supply chain. China is reliant on commodity producers such as Brazil and Chile for food security and raw materials, and these countries will continue to maintain “active nonalignment”, prioritising their own interests whilst remaining neutral on US-China competition.

- In Central and Eastern Europe, the Russia-Ukraine war has pushed governments and populations further into alignment with the West. Net migration into neighbouring countries will likely bolster economic activity and mitigate labour shortage issues. Western European economies seeking supply chain security may increasingly nearshore production to Eastern European territories.

The world is realigning itself for the multi-polar era of great power competition between China and the US. Navigating these unfamiliar waters will test many investors, but one can be certain that remarkable new investment opportunities will emerge. As Einstein put it: “In the midst of difficulty lies opportunity”. The difficulties are evident; the opportunities are not. But they are out there, ready to be discovered, by those intrepid enough to go looking.

Jonathan Groocock
26 June, 2023

Source Data: ICM Limited as of 20 June, 2023.

[1] IMF Trade (% of GDP) | Data (worldbank.org)

*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares