ClearBridge
A Franklin Templeton Company

# Emerging Markets Strategy

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## Key Takeaways

- A growth scare and lower bond yields helped defensive areas of the market outperform in August, although emerging markets underperformed developed markets due to risk aversion.
- Historically, infrastructure has outperformed global equities when interest rates peaked, something to keep in mind as inflation indicators slow and allow major central banks to move towards cutting rates.
- In this environment, we believe infrastructure's defensive qualities and its income stability will become more apparent, as has been evident during recent market selloffs.

## Market Overview

A growth scare and lower bond yields helped defensive areas of the market outperform in August, with global listed infrastructure making strong gains and outpacing global equities.

The rotation towards a risk-off market sentiment was due to a combination of weak economic data from Europe, disappointing technology-related earnings results, softer than expected job reports from the U.S. and the unwind of the Japanese Yen carry trades.

The Yen carry trade unwinding hurt Asian equity performance in early August, while the Philippines market was boosted by rate cuts. The Chinese market was volatile which was driven by the internet stock sell-off, property market weakness and second quarter reporting season.

## Portfolio Performance

The ClearBridge Emerging Markets Strategy outperformed global equities, though were outpaced by relevant infrastructure benchmarks during the month.

On a regional basis, Latin America (+1.75%) was the top contributor for the month, with Mexican airport operator Grupo Aeroportuario del Pacifico (+0.45%) the lead performer in the region. Grupo Aeroportuario del Pacífico (GAP) is Mexico's largest airport operator with a portfolio of 13 airports focused on Mexico's Pacific region with an additional airport in Jamaica. GAP was an outperformer following a constructive tariff review which yielded allowed price increases of +25%.

Turning to the Asia Pacific, Philippines-based port operator International Container Terminal Services (ICTS) also contributed to monthly performance (+0.48%). ICTS operates terminals through long-term concession agreements with local port authorities and governments. ICTS share prices rose as the company reported a second-quarter result beat with record-high yields.

Chinese toll road operator Shenzhen Expressway (-0.31%) and Indian energy infrastructure company Gujarat Gas (-0.36%) were the largest detractors.

Shenzhen Expressway is the operator of several toll road assets in Shenzhen and other parts of Guangdong province in China. It also has stakes in some toll roads in other provinces and an environmental business. The unexpected impairment and weakness in the environmental business in the company's second-quarter results impacted Shenzhen Expressway's share price.

Gujarat Gas is a city gas distribution business. It is one of India's leading natural gas distribution companies, processing and distributing compressed natural gas and liquefied petroleum gas to transport, domestic, commercial and industrial consumers, with a nationwide portfolio of last-mile city gas concessions and the longest operating track record amongst the listed players. The rise in LNG prices caused margin concerns for Gujarat Gas.

During the month, we exited our position in Thai airport operator Airports of Thailand.

All returns are in local currency.

## Positioning & Outlook

Historically, infrastructure has outperformed global equities when interest rates peaked, something to keep in mind as inflation indicators slow and allow major central banks to move towards cutting rates. In the current cycle, peaking interest rates have created a significant opportunity, as listed infrastructure has underperformed general equities, making the sector more attractively valued.

We are expecting bond volatility to reduce and market excitement for AI and technology-related stocks to dissipate. In other words, market breadth should broaden. Therefore, as that occurs, we are expecting that the market will begin to recognise the strong fundamentals and long-term themes of the infrastructure asset class, especially higher-growth utilities. This includes those in emerging markets benefiting from rising urbanisation and industrialisation rates.

Given the prospect of slowing growth from elevated levels, it is not surprising to see equity market volatility. We believe infrastructure's defensive qualities and its income stability will become more apparent, as has been evident during recent market selloffs. Further, we continue to see positive earnings revisions for regulated and contracted utilities, based on a pass-through of inflation and on the growth in their underlying asset bases. In emerging markets, we welcome the better-than-expected dividend across China as evidence of the SOE reform theme playing out, while we watch for political uncertainties in Mexico from a controversial judicial reform.