Trump’s Win Creates a Period of Uncertainty for Emerging Markets

Valuations in many markets are broadly cheap, and since a great deal of uncertainty is already priced in, there may be opportunities to consider adding to exposures in the coming months.

Insight from sub-adviser Schroders Investment Management

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Key Points

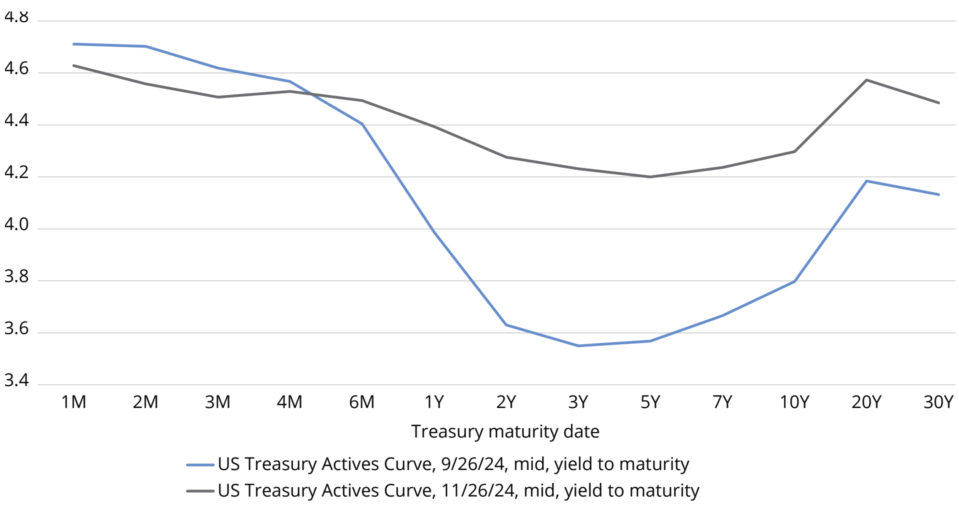
- The outlook for emerging-market equities is uncertain due to potential tariff risks, a strong US dollar, and higher US bond yields.
- China has visibly made a more coordinated attempt at policy support, but the follow through on fiscal policy has disappointed markets so far.
- India’s market is richly valued, but recent slower nominal growth and tighter fiscal and monetary conditions may present investment opportunities.

The outlook for emerging-market (EM) equities is colored by uncertainty relating to the impact of a Trump administration. Valuations, excluding India and Taiwan, are broadly cheap, but markets are facing a period of uncertainty. Key drivers include tariff risk, a strong US dollar, a higher US yield curve (higher US bond yields), Chinese policy action, India, and technology trends.

President-elect Trump’s proposed policies are expected to put upward pressure on US inflation, which would lift the US yield curve and support the US dollar. This would tighten financial conditions in EM and acts as a headwind to market performance.

However, we’ve already seen a significant move in the US dollar, which is pressuring EM currencies, many of which screen as cheap. Meanwhile, US bond yields and rate expectations have also adjusted markedly, and EM real interest rates (adjusted for inflation) are elevated.

FIGURE 1
US Yield Curve Has Moved Higher in Response to Trump’s Proposed Policies
Yield (%)



As of 11/26/24. Past performance does not guarantee future results. The yield curve is a line that plots interest rates of bonds having equal credit quality but differing maturity dates; its slope is used to forecast the state of the economy and interest-rate changes. Sources: Bloomberg, Schroders.

Trump also brings tariff risk, both in relation to broad-based tariff application (on all imports into the US) and a significant increase in tariffs specific to China (an increase to 60% was raised in campaign rhetoric). If tariffs are implemented rapidly and in line with campaign rhetoric, part of the impact would be absorbed via EM currency depreciation, but there would likely be a substantial impact on US inflation. This would disproportionately affect lower income households, a key element of Trump's support base. Consequently, we'd expect a more nuanced approach to tariff application than suggested by campaign rhetoric.

In relation to China specifically, Trump's cabinet appointments look to be broadly politically hawkish toward the country. So we'd expect asymmetric tariffs to be applied. Depending on scale, this could impact China's trade volumes and may lead to a significant renminbi (China's currency) devaluation, though it may also drive an acceleration in Chinese stimulus to defend growth.

A significant renminbi devaluation may pressure competing EM currencies, although on a medium-term basis, competing EM manufacturing economies may benefit from ongoing supply-chain diversification away from China.

Finally, as far as Trump's impact on geopolitics, there are both potential risks and opportunities. As noted, Trump's team looks hawkish on China, and a decoupling process is expected to continue, which may not always be smooth. In Ukraine, if a peace deal is accompanied by sufficiently strong security guarantees, this and significant reconstruction spend could benefit emerging European economies and risk premia.[1]

China's Economy and Market May Remain Sensitive to Policy Announcements

In China, there was a visible move toward more coordinated and determined policy support in September. However, monetary policy settings remain tight, and the follow through on fiscal policy has disappointed markets. The trade cycle is expected to soften through 2025, and China now faces tariff risk from a Trump administration. However, the domestic economy is at a low base, and there are some signs of stabilization in real-estate markets in the largest "tier 1" cities, the most developed cities in the country.

We believe there's now a stronger policy backstop to China's economy and market. Policy announcements can drive the market, and positioning remains relatively supportive (foreign investors remain underweight the market, and domestic cash balances are high).

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There May Be an Opportunity to Consider Adding to India in Coming Months

In India, the market is richly valued vs. history, profit margins and earnings expectations are elevated, and escalating equity supply has increasingly offset strong domestic fund flows. Most recently, nominal growth (i.e. growth unadjusted for inflation) has slowed, led by tighter fiscal and monetary conditions, and the market has softened as earnings expectations are challenged. This may present an opportunity.

The rainy season was good in 2024, which typically leads to an improvement in rural incomes, while there is some scope for monetary easing. India is also geopolitically neutral, less exposed to tariffs vs. other EM, and has an interesting structural growth opportunity.

Finally, foreign investors have low allocations to the market. We'll be monitoring the market in the coming months, looking for a sufficient reset in valuations and earnings expectations to lift our exposure.

Will the Technology Cycle Continue Into 2025?

We've been moving through the technology cycle, led by AI. The valuations of technology companies are higher, and there's uncertainty regarding the sustainability of AI-related capital expenditure, given the lag on monetization.

We see momentum sustaining in the near term given the potential in the technology and the reluctance of any "hyperscaler" (the big US providers of AI infrastructure) to lag its peers.

Other areas of the technology sector remain soft and in an extended downcycle. Here, we may see an improvement off a low base in the sector through 2025, supported in certain cases by improving product cycles.

Valuations Are Broadly Supportive, But Uncertainty Reigns in the Near Term

In the near term, there are three key areas of uncertainty: the impact of a Trump administration, AI momentum, and Chinese policy support. But valuations in many markets are broadly cheap, as are EM currencies. Much is priced in, and a stressed or uncertain environment may provide opportunities to consider adding to exposures in the coming months.

Talk to your financial professional about the opportunity in emerging-market equities.

[1] Risk premia is the investment return an asset is expected to yield in excess of the risk-free rate of return.