CALAMOS INVESTMENTS

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Global Opportunities: The Case for Emerging Markets Is Strong

» ASEAN* consumer demand trends and reopening beneficiaries are nuanced; we are identifying attractive opportunities in higher-end travel.

» Nearshoring and friendshoring provide tailwinds for emerging markets, including Mexico and India.

» There is a fundamental case for relative stability in many high-quality emerging market banks in countries such as India, Indonesia, Mexico and the Philippines.

We expect near-term global market volatility to remain elevated as asset classes adjust to elevated inflation and tighter monetary conditions. Since this tightening cycle has begun, we've seen rolling shocks to the crypto markets and British pension funds, and now to regional banks. Although unpleasant, this sort of volatility is normal at this stage of the cycle as the excesses that built up when monetary conditions were very easy are now being worked out of the system.

Typically, these excesses are within the emerging markets. However, during this tightening cycle, most emerging markets are in a much better position. Many are positioned to prosper from an acceleration of growth due to the reorientation of global supply chains and reopening of ASEAN economies. We remain optimistic about global risk assets in 2023 and maintain our preference for non-US exposure. Below, we highlight three key themes we see supporting opportunities.

ASEAN Reopening

We are happy to report our team has made several research trips to Asia in recent months, a welcome return to travelling to the region after three years of Covid-related restrictions. Of course, we've been engaged in these markets over past years through our on-the-ground contacts and corporate access, but there is value in seeing and experiencing the energy of these markets firsthand. We were excited to once again meet face-to-face with management teams and tour some of the facilities of the companies in our portfolios.

Our travels left us with optimism and some concern. We are extremely optimistic about the pent-up demand that is being released and the overall health of the economies that were ravaged by extended lockdowns. However, we do have some concern that the pace of reopening and revenge spending may be much slower than what we experienced here in the US and Europe. We are seeing a bifurcation of demand in emerging markets similar to what we saw in developed markets. High-end hotels, shops, and restaurants are full, and company managements are reporting a sharp recovery and steady demand.

*ASEAN: Association of Southeast Asian Nations, including Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

In contrast, the rebound has been considerably more muted within segments that rely more on spending by the middle class. For example, Chinese outbound flights remain an impediment to this recovery. A shortage of English-speaking pilots is preventing a further ramp-up in air travel. As a result, many outbound routes are cost prohibitive for middle-class travelers. We also witnessed service-sector labor shortages in the emerging markets we visited that reminded us of those occurring in the United States. In this case, many emerging market service-sector workers either entered new industries that were hiring during Covid or returned to their villages to work the family farm.

We believe these challenges will be resolved and we have found opportunities to invest selectively in the domestic mass-travel recovery. However, we are focusing our near-term efforts on companies that are positioned to benefit from high-end outbound travel recovery.

Nearshoring and Friendshoring Provide Growth Tailwinds

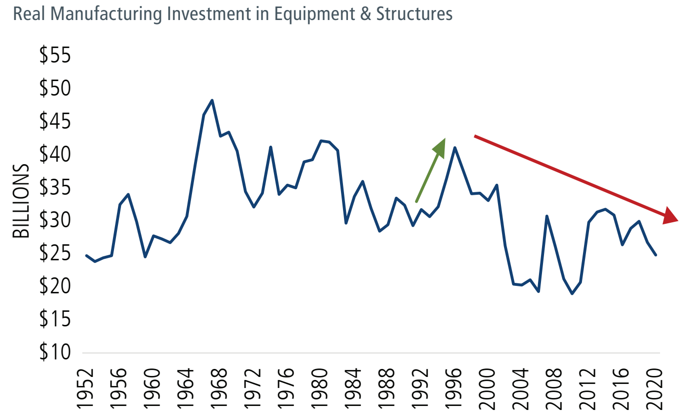
Thematic tailwinds can support growth for companies through an otherwise turbulent macroeconomic environment. For example, we are identifying companies in the manufacturing, capital goods, engineering and construction, transportation, semiconductor, and real estate industries that are positioned to benefit from nearshoring and friendshoring.

Nearshoring refers to the reorientation of supply chains by companies seeking to move production closer to the customer and diversify their dependence on concentrated regions of production. Although there is often overlap with nearshoring, friendshoring refers to moving production to a country with a favorable relationship to diversify production. This new location may not be geographically close to the customer as it is with nearshoring. Although both trends were in place before 2020, global supply chain disruptions caused by the onset of Covid and the war in Ukraine have materially accelerated these trends.

During decades of globalization, many companies moved production to countries in Asia to take advantage of lower production costs. In more recent years, rising wages in some of these countries and the costs and risks associated with disrupted supply chains have forced companies to reexamine where they produce their goods. We are seeing this dynamic occur across many industries and in multiple regions.

This includes many US companies that are increasing production of goods not only in the United States but also nearby in Mexico, which is a cheaper manufacturing

Figure 1. Mexico: Positioned to benefit from a reversal in US capex



Source: Macrobond.

location. For example, the United States is aggressively building semiconductor capacity, and multiple auto companies are establishing or expanding capacity in Mexico. The United States has not had a major capex boom in nearly two decades, and we believe the capital invested in the United States and Mexico will be positive for many capital goods and technology companies. This spending also can act as an additional economic support level for an emerging economy such as Mexico.

Meanwhile in Asia, India's Make in India initiative is driven not only by India's desire to locally manufacture more of the products consumed in India but also by India's active push to become a larger manufacturing hub for Asia. The Indian government continues to provide subsidies to companies looking to increase manufacturing capacity in India, with the most recent annual government budget specifically emphasizing capex investment growth. Other countries in the ASEAN region, such as Vietnam, should also benefit from the realignment of supply chains as companies diversify their sources of manufacturing capacity.

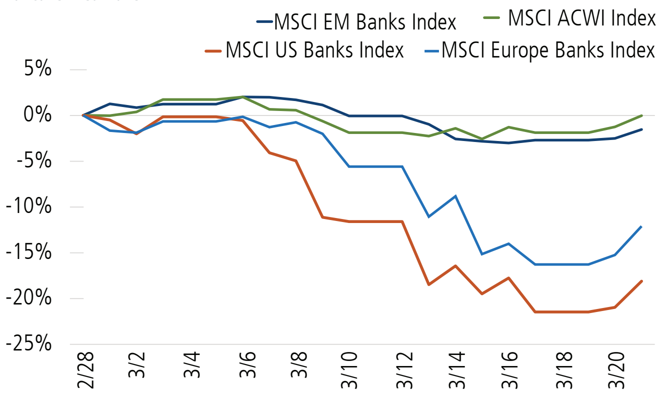
Emerging Market Bank Stocks Have Demonstrated Resilience

The misadventures of Silicon Valley Bank and Signature Bank in the United States and Credit Suisse in Europe have been well documented, so we don't need to go into detail. At the end of the day, banks operate business models reliant on liquidity transformation and leverage. No bank can survive a run on deposits as significant as these institutions experienced. The rising interest rate environment and tightening of financial conditions provided a catalyst and will continue to pressure the fundamental backdrop for banks, but poor company-specific asset-liability management—and in the case of Credit Suisse, a variety of other forms of mismanagement—took these banks over the edge.

What's interesting about this episode is the extent to which US banks have been disproportionately hurt thus far. The conventional perception post-GFC has been that US banks were the saftest globally. Year-to-date share price performance conflicts with this view. Indeed, it's been EM banks that have held up best globally (Figure 2), and this is not entirely surprising on a fundamental level. As we've discussed, increasing consumer wealth and access to financial services and products are powerful growth themes across many emerging market economies, but less impactful in developed economies.

Figure 2. EM bank stocks have held up better than those in Europe and the United States

2/28/23 – 3/21/23



Source: Bloomberg. **Past performance is no guarantee of future results.**

Because these secular trends tend to be at relatively early stages in emerging markets, local savers have fewer alternatives for deploying and redeploying savings. For the banks specifically, on the liability side, term deposits (e.g., certificates of deposit) tend to represent a much higher percentage of funding for banks in developing economies. As a result, the deposit betas in emerging markets are comparatively lower than developed markets. On the asset side, emerging market banks tend to be more "vanilla." Loans as percentage of deposits tend to be much higher than for developed market banks, so mark-to-market losses and resulting capital adequacy issues may be less of an issue.

Of course, underwriting standards and loan quality matter, but the highest quality banks in countries such as India, Indonesia, Mexico and the Philippines have demonstrated strength in this regard. Put it together, and there is a fundamental case for relative stability in many of these emerging market banks. Clearly, these banks are in economies that are still vulnerable to global shocks. If the United States or Europe suffer severe recessions over the next year or if we enter a global liquidity crisis, emerging markets could not avoid adverse effects given the economic and financial connections that are still in place.

History offers several examples of financial crises across emerging markets over the past 30 years. There are three points to consider:

1) Emerging market financial crises tend to be preceded by periods of large capital inflows, and particularly portfolio inflows, into emerging markets. We have not seen such inflows over the past several years.

2) A US dollar liquidity squeeze has been the catalyst for capital flight. We have been seeing the US dollar weaken since the third quarter of 2022.

3) China, a significant end market for many of these emerging market economies, is in the process of reopening after years of zero-Covid-policy lockdowns and is easing monetary conditions.

Conditions can change, and the US dollar will continue to be a critical signpost to monitor, but at this point we aren't seeing the types of conditions that preceded previous periods of economic and financial weakness in emerging markets.

Against this backdrop, emerging market banks versus developed market banks look like a microcosm of the broader positive case for higher exposure to emerging markets.

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MSCI Emerging Markets Index is a free float adjusted market capitalization index. It includes market indexes of Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. The MSCI ACWI Index is a free float adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets and emerging markets. The MSCI EM Banks, MSCI Europe Banks Index, and MSCI US Banks Index is a measurement of the performance of banking stocks within emerging markets, Europe and the United States, respectively.

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