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PUBLIC EQUITIES

Emerging European Equities: Key Areas of Opportunity

INSIGHTS

From a more constructive outlook, to structural growth trends, to attractive valuations, there are a number of factors converging to create compelling opportunities in Emerging European equities.

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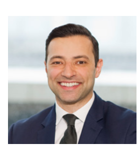

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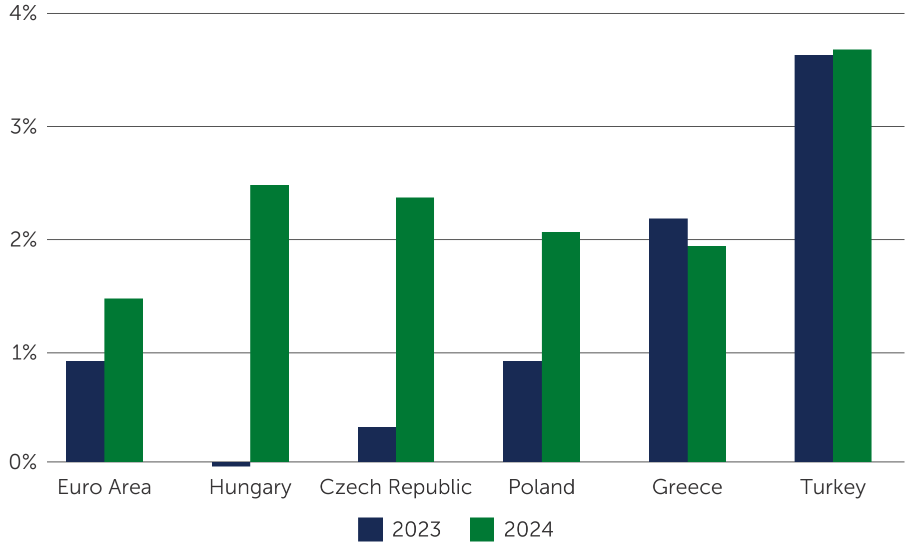
Emerging European markets have faced a myriad of challenges recently—from Russia's invasion of Ukraine, to the broader global headwinds of inflation and rising interest rates. This resulted in heightened volatility and, at times, lead to significant selloffs across the region's equity markets.

Despite the broader challenges, it appears that a number of factors are converging across Emerging Europe to create unique investment opportunities today. For instance, the economic outlook in Europe is more constructive than was feared 18 months ago, helped by the significant easing of energy prices, while growth rates for Emerging European countries look attractive relative to the broader Euro area. At the same time, there are several long-term structural growth trends providing support to the region. This backdrop, in combination with attractive current valuations, is presenting a compelling opportunity in Emerging European equities.

Country-specific Factors Provide Long-Term Support

Emerging European countries are forecast to grow between 2%–4% in 2024, outpacing that of the broader Euro area **(Figure 1)**. These robust economic growth forecasts should be underpinned by rising incomes and consumption trends, which in turn are likely to be reflected in improving corporate earnings—and subsequently an increase in investor confidence in the region. These encouraging macroeconomic trends are supported by a number of compelling country-specific factors that we believe contribute to the long-term appeal of the region.

Figure 1: Emerging Europe Growth Likely to Outpace Euro Area

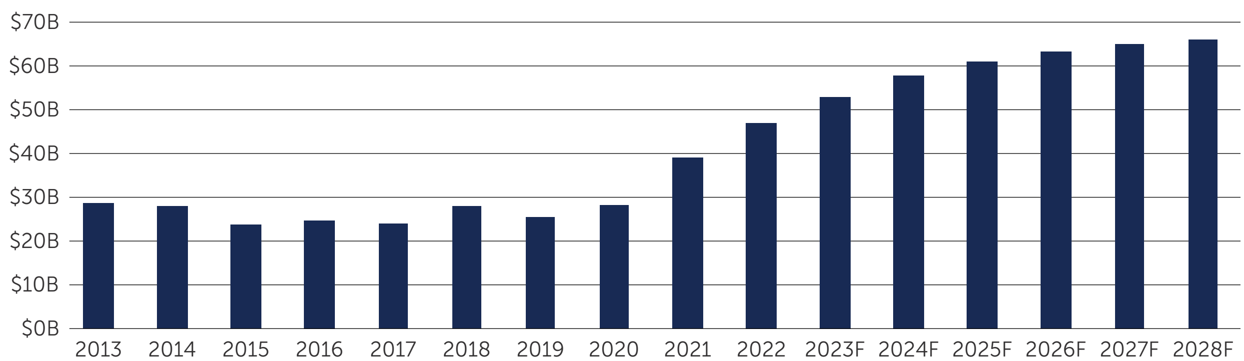


Source: OECD. As of June 2023.

GREECE

More than a decade after Greece teetered on the edge of a Eurozone exit, the country has defied critics and rebounded, delivering GDP expansions of 8.4% in 2021 and 5.9% in 2022.[1] While Greece owes in part its economic recovery to its position as a traditional tourist destination, which accounts for about one-fifth of GDP in a strong year[2], the country has also benefitted from significant investment **(Figure 2)**—a critical economic building block. This growth in investment has stemmed from its place as a growing **exporter of services**, which has increased over recent years. For example, Microsoft has invested in Greece via their "GR for Growth" project, which involves building new data centers that provide low-latency, enterprise-grade cloud services. This investment puts Greece among the digital leaders of Europe and allows Microsoft to export its cloud services globally. The investment also has domestic benefits, helping to accelerate the digitization of numerous sectors, while providing training in digital technologies for a minimum of 100,000 people by 2025.[3]

Figure 2: Greece Sees Rising Total Investment



Source: IMF World Economic Outlook database. As of April 2023.

Clean energy is another area of development, where Greece's warmer, sunnier climate, combined with its coastal winds, give it a unique opportunity to become an energy exporter of the future. The Integrated National Energy and Climate Plan for Greece aims to increase the overall share of renewable energy sources in the country's energy supply to 35% by 2030, with the electricity sector targeted to rise to at least 60% by 2030.[4] This initiative will not only increase the use of renewable and clean energy, but it will also likely enhance the country's energy security, potentially creating jobs and driving further investment.

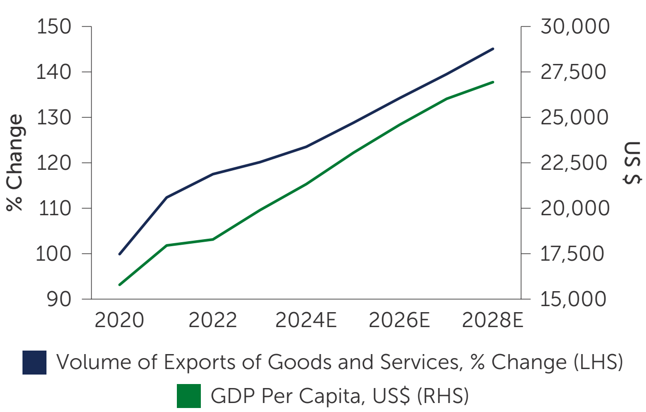
Importantly, the merits of this impressive and hard-fought economic recovery have begun to bear fruit on the international stage, with Greece one of the best performing global equity markets in 2023.[5] In addition, Greece is on the cusp of potentially regaining its investment grade credit rating, more than 12 years after losing it during the euro area's sovereign debt crisis. This structural shift has lowered the cost of borrowing for Greece's government and allowed for a stable funding base for the country's future needs.

1. Source: World Bank. As of June 2023.
2. Source: OECD. As of June 2023.
3. Source: Microsoft. As of October 2020.
4. Clean energy for EU islands: Study on regulatory barriers and recommendation for clean energy transition on the islands Greece. As of December 2022.
5. Source: Factset. As of June 2023.

CENTRAL AND EASTERN EUROPE

Impacted by pandemic-led supply chain disruptions and growing geopolitical tensions, many EU companies have begun to rethink their supply chains. Eager to mitigate supply chain risk, a number of companies are exploring the option to relocate their operations closer to their target markets, a process known as **nearshoring**. New EU member states are well placed to accommodate this trend given their skilled labor markets, strong regulatory protection and alignment with the EU—and, crucially, a faster delivery time due to their closer geographical proximity. For instance, within the auto industry, Slovakia now produces more cars than the U.K.[6] In addition, countries such a Poland, which have had a longstanding association with shared services centers and business process outsourcing, are seeing ever-more sophisticated business services being moved to the country, including services from Google, Accenture, IBM and U.S. investment banks JP Morgan and Goldman Sachs. As this evolves, the IMF anticipates that the volume of goods and services as a percentage of GDP will continue to grow, making it an export powerhouse within Europe—and, in turn, raise the wealth of citizens and improve disposable incomes and consumption patterns.

Figure 3: Increasing Growth in Exports and Per Capita GDP in Poland

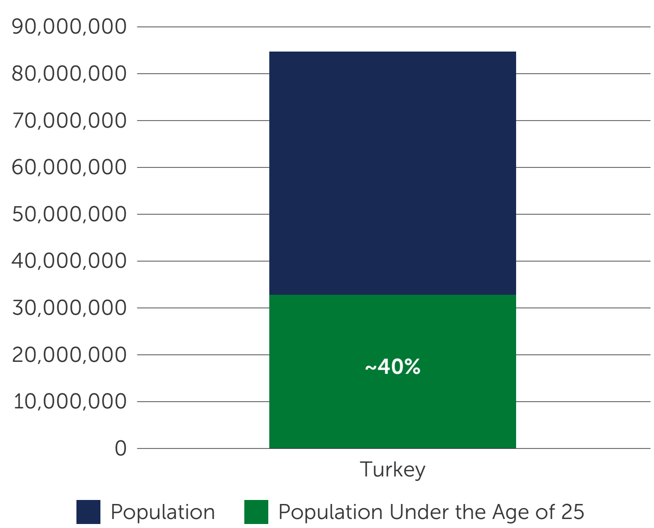


Source: International Monetary Fund; World Economic Outlook database. As of April 2023.

TURKEY

Turkey is unique among European nations, boasting a large and relatively young population of over 80 million people, of which approximately 40% are under the age of 25 years **(Figure 4)**. This compares favorably to Europe as a whole where the number of citizens under 25 is much lower, at approximately 25%.[7] This increase in the working-age population offers an opportunity for accelerated economic growth, in what is known as a "demographic dividend". This demographic dividend is supportive for job creation and per capita income and should be beneficial not only for companies that operate within the region, but also for the consumption patterns of citizens as they become wealthier. In addition, having honed their business skills and expertise in the volatile yet rapidly expanding domestic economy, Turkey's best in class companies have begun to expand globally. This includes Koc Holding subsidiary companies such as Ford Otosan, which produces three-quarters of all commercial vehicles sold in Europe. In addition, durable goods company Arcelik has a business today that includes subsidiaries in 53 countries, producing internationally recognized brands such as Beko.[8]

Figure 4: A Significant Young Population in Turkey



Source: United Nations. As of June 2023.

6. Source: International Organization of Motor Vehicle Manufacturers. As of June 2023.
7. Source: United Nations. As of June 2023.
8. Source: Arcelik. As of June 2023.

The recent elections in Turkey saw President Erdogan defeat opposition leader Kemal Kilicdaroglu to extend his rule to a third decade. While this will undoubtedly present challenges for the country, given Erdogan's historic approach to unorthodox monetary policy, the potential of the Turkish economy and the entrepreneurial businesses that operate within it, remain significant, in our view. While bridging the gap with international investors won't come without challenges, recent indications that the Erdogan administration may be taking a more orthodox stance are welcomed, with the hiring of Mehmet Şimşek, a former deputy prime minister well regarded by investors as finance and treasury chief. This, we believe, may be a nascent sign that clearer and consistent economic policies could potentially return.

Opportunities Beyond Emerging Europe

Looking across the market, there are opportunities further afield in areas such as the Middle East and South Africa. In these regions, we see compelling opportunities in export-focused sectors such as energy and materials, alongside unique domestic stories.

While energy prices have fallen from their peaks, many governments are still looking to find alternative ways to meet their energy needs and reduce dependence on Russia via alternative suppliers. We believe this shift will continue to benefit the hydrocarbon dominant economies of the Middle East in markets such as Saudi Arabia and Qatar, and could likely allow for further investment into the diversification of their economies. This is seen most prominently in Saudi Arabia's "Saudi Vision 2030" program, which has set out an ambitious agenda to reduce dependence on oil, and develop public service sectors such as health, education, infrastructure, recreation and tourism. Here we are already seeing a number of exciting opportunities in the privatization of state assets, alongside a growing domestic base of entrepreneurial companies.

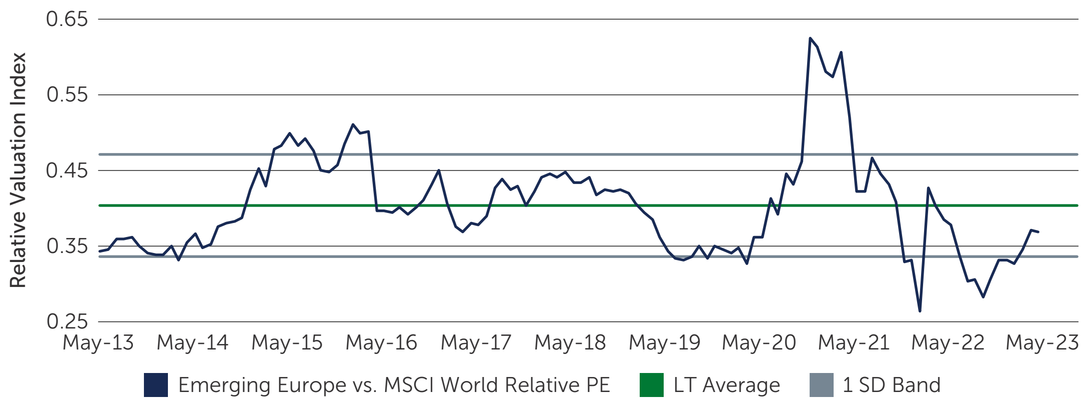
"Looking across Emerging Europe and selectively further afield, we believe opportunities exist in companies that are exposed to a range of secular growth trends—in particular, companies with flexible business models, improving franchises, and unrecognized growth opportunities."

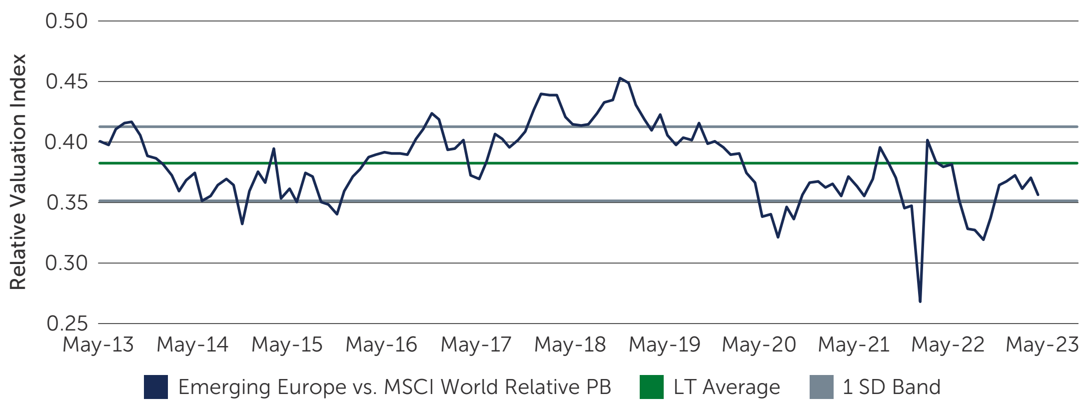
There are also opportunities related to the **energy transition** toward a world less dependent on fossil fuels. This shift requires substantial investments in solar and wind generation capacity, critical areas of development for the EU, and will involve mining and processing significantly higher amounts of raw materials—namely copper, aluminum, nickel, platinum group metals and rare earths, often referred to as 'green metals'—than we have in the last 30 years. Some of the largest mining companies in the world that are well-positioned to help meet these demands are located in South Africa due to the country's abundant supplies of natural resources, making these export-orientated businesses particularly attractive long-term investments.

Attractive Valuations

In addition, from a valuations perspective, Emerging European equities look compelling today. The MSCI Emerging Europe index is currently trading at a significant discount relative to the MSCI World index on both a price-to-book and price-to-earnings basis **(Figure 5)**.

Figure 4: Emerging European Equity Valuations Appear Attractive vs. Global Markets





Source: Factset; MSCI. As of June 2023.

Key Takeaway

Looking across Emerging Europe and selectively further afield, we believe opportunities exist in companies that are exposed to a range of secular growth trends—in particular, companies with flexible business models, as well as those with improving franchises, unrecognized growth opportunities and other competitive advantages. As a fundamental, bottom-up manager, we monitor companies closely to best identify strong management teams that are aligned with shareholders and other stakeholders to the business. While near-term risks and uncertainties—whether around the lasting impacts of inflation, politics, or economic growth—will likely continue to drive headlines for the foreseeable future, the long-term growth opportunity in Emerging Europe remains compelling.

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**As of March 31, 2023*

23-2983544