FINANCIAL POST

Emerging markets are the booming tech play few are talking about, this fund manager says

More over FAANG, tech has become a massive industry in markets like China and India — and it's only going to get bigger

Jonathan Ratner, Financial Post, September 7, 2017

When most investors think about technology stocks, the U.S. equity market — and Facebook, Amazon.com, Netflix and Google in particular — usually comes to mind. So they may be surprised to find out that technology has become the biggest sector in the benchmark MSCI Emerging Markets Index.

It's also larger than in the U.S. as a percentage of market cap, and in China, about 50 per cent of the index is technology. That compares to just five per cent 15 years ago.

Investors should be familiar with Chinese companies like online and mobile commerce giant Alibaba Group Holding Ltd., leading internet search firm Baidu Inc., and online advertising, payment and games provider Tencent Holdings Ltd. But there are many more stocks to choose from, specifically in areas linked to smartphones, e-commerce, online gaming, and mobile payments.

"All those things are booming in China," said Laurence Bensafi, deputy head of emerging markets equities at RBC Global Asset Management.

She noted that e-commerce as a proportion of sales (20 per cent) in China, is the highest of all countries, and much higher than the U.S. at roughly 10 to 12 per cent. This industry is also growing at a rate of 50 per cent per year in China.

"In China, you went from having very little retail sales (because as a poor country there were few shops, so people didn't buy much), to the internet," the London-based portfolio manager said during a recent visit to Toronto. "A lot of emerging market countries are going to skip some steps. It's a massive industry, and it's going to get bigger."

It's not only the software and services sectors that are booming, but hardware is also getting incredibly big because something needs to be behind all the apps and e-commerce activity.

“For a smartphone, you need memory, for example,” Bensafi said. “Almost all of that is done in Taiwan, Korea and China.”

While China was often thought of as a provider of low value-added products, that has changed dramatically over the past few years due to massive wage increases. Industries such as semiconductors have benefited, while low value-added products have been hurt, particularly textiles, which have largely moved to places like Bangladesh, Vietnam and India.

Having 600 million people move into the middle class also has a very positive economic impact, particularly when it comes to consumption trends in China.

Bensafi, who manages the RBC Emerging Markets Equity Fund, the RBC Emerging Markets Dividend Fund, and the RBC Emerging Markets Small-Cap Equity Fund, highlighted Samsung Electronics Co. Ltd. (Korea) and Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC) as top holdings.

Samsung does a lot of things, but is best known for its smartphones and TVs.

“What is doing amazingly well is their memory business,” Bensafi said, noting that is entirely linked to the digitization of the economy. “You need memory everywhere, and everything is connected.”

Once a boom-and-bust industry with many players, things have changed dramatically in the past few years. There are now three primary players, and demand is exploding.

“These companies are much more disciplined, so the amount of money they generate is extremely impressive,” Bensafi added.

For TSMC, despite being well-known by investors, the market got it wrong on this semiconductor manufacturer.

“The company made good money and had good margins, but it was very cheap as people didn’t see growth in that segment,” the portfolio manager said. “But the company delivered on growth, and investors didn’t anticipate the huge demand for digitization — things like servers.”

She also noted that TSMC it is well ahead of its competition when it comes to technological advantage and size, making it very difficult for other companies to catch up.

Bensafi is playing several themes in these portfolios and always focuses on remaining diversified, but a related trend she is playing in technology is the rapid growth of electric vehicles and driverless cars.

“Some people think the technology is not ready, but due to falling costs for batteries and other factors related to autonomy, we think it is going to happen much faster than people think,” she said.

When it comes to cars and driving, millennials have a completely different view than previous generations. Having an expensive car isn't nearly as important anymore, and they are much more conscious of the environment.

Bensafi noted that investors can play this trend through technology firms in Korea, Taiwan and Japan that make batteries, camera modules, sensors and advanced driver assistance systems. But there will be losers, as the shift to electric vehicles will lead to a massive drop in demand for refined energy products.

At the same time, the money saved on gasoline will have a huge impact in terms of discretionary spending. Insurance companies will be impacted because the responsibility is going to shift away from drivers.

"Car makers are going to be responsible for the insurance and safety," Bensafi said.

She believes the big losers will be the car makers, as they've long wanted to be design companies like Apple Inc. and rely on other companies for auto parts.

"That was good when it was low valued-added products, but now it's technology and they don't have any of the knowledge," the portfolio manager said. "There is going to be way less branding and differentiation. When you call an Uber, you don't really care what kind of car it is. If it's nice, great, but you don't own it."

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