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Emerging-Market Tech Stocks Upstage FAANGs

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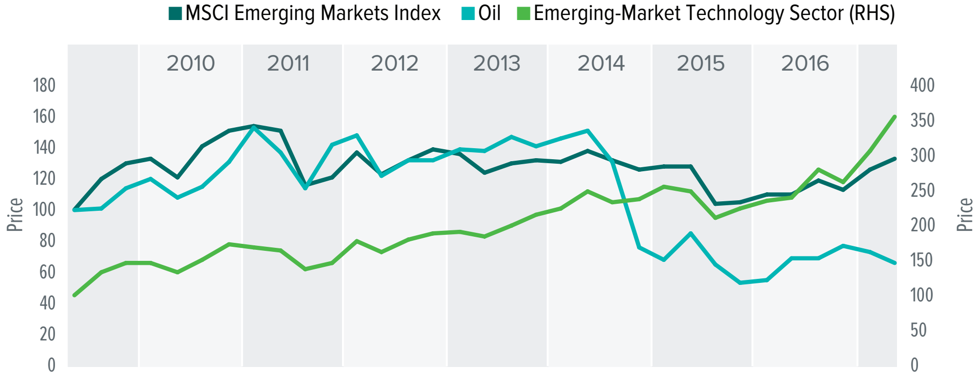
Sandra M. Ackermann-Schaufler, CFA
Senior Portfolio Manager - International and Emerging Markets Equity Team

Snapshot

- Investors have traditionally associated emerging markets with commodities and infrastructure.
- Today, the MSCI Emerging Markets Index is dominated by the information technology and financial sectors.
- The influence of technology stocks in today's emerging-market indexes partly reflects the importance of technology companies in the economic growth of Asian countries.

Twenty years ago, the MSCI Emerging Markets Index was made up of companies from a variety of sectors and countries that were traditionally associated with commodities and infrastructure. As a result, its performance closely tracked the price of oil. This all changed in 2014, when oil prices began to trend sharply lower—and the Index began to more closely follow information technology shares as those companies grew in importance (Exhibit 1).

Exhibit 1: The Emerging Influence of Technology



Normalised to 100 as of 06/01/2009
Source: SEI, FactSet

The recent outperformance of emerging-market technology companies points to the fact that technology is now the largest sector in the Index—and that top contributors to a given index tend to be from the same sector (while the opposite also typically holds true, as the biggest detractors during market declines usually fall within a single group.)

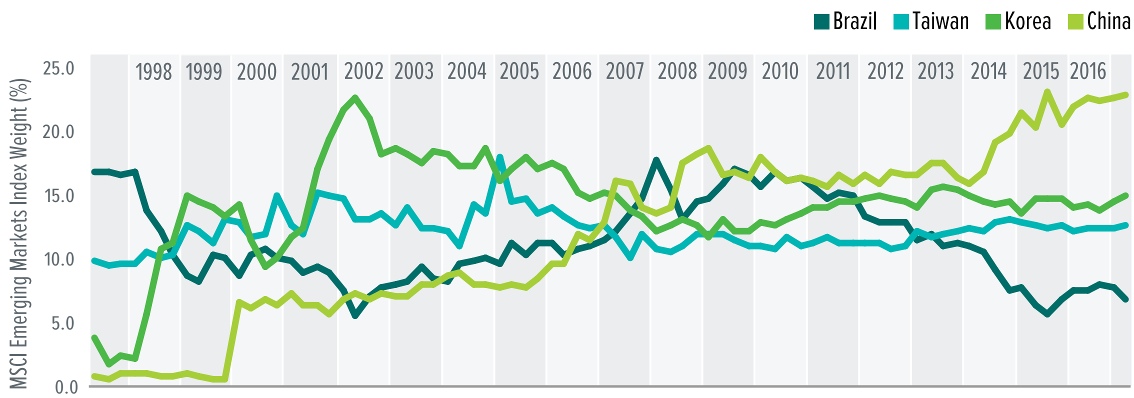
Tech Rises in Asia

Much has been made about the influence of the technology sector on US markets over the last several years—and understandably so, considering the so-called FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) occupy about 9% of the Russell 1000 Index (US large-cap benchmark) as of June 30, 2017.

Yet the technology sector has gained an even greater presence within emerging markets. Over the past 20 years, technology companies went from comprising just 1.5% of the MSCI Emerging Markets Index market capitalization in 1997 to nearly 27% in 2017. The top-five market-capitalization-weighted stocks in the Index are technology companies Samsung, Alibaba, Naspers, Tencent and Taiwan Semiconductor. Collectively, they make up nearly 18% of the Index. By comparison, in 1997, the top-five stocks by market capitalization were a mix of telecommunications and utilities companies that occupied just 10.5% of the Index.

The MSCI Emerging Markets Index has also undergone a big transformation in geographical terms. Driven by the growing importance of China in the Index, it is now dominated by Asian countries (Exhibit 2). This reflects the rise of China's economy, as well as the expanding reliance on internet usage across the globe. China's weight in the Index is expected to continue to grow along with the gradual increase of the country's A share stocks.

Exhibit 2: The Growth of China

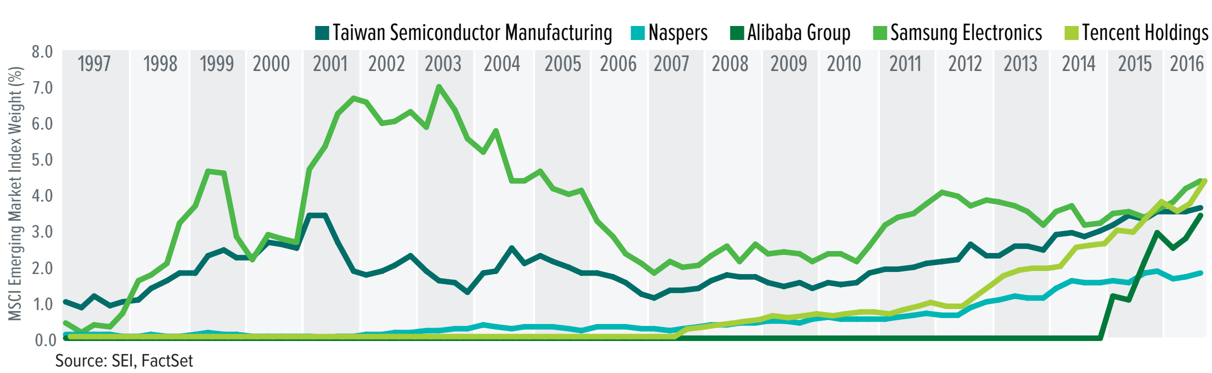


Source: SEI, FactSet

IT Drives Gains

Investors in both US and emerging markets who avoided technology stocks in the first half of 2017 would have struggled to keep up with the performance of the benchmark indexes in their portfolios. But the consequences were even greater for those who failed to invest in emerging-market tech stocks, with a resulting 32% loss of the MSCI Emerging Market Index's overall return (in US dollars)—compared to a 21% loss of the Russell 1000 Index's overall return driven by lack of exposure to US FAANG stocks. Exhibit 3 highlights the growing importance of selected emerging-market technology stocks through the first half of 2017.

Exhibit 3: Emerging Tech Powers Gains in 2017



Source: SEI, FactSet

SEI's View

We believe emerging-market stocks offer compelling opportunities; their valuations have grown increasingly attractive compared to recent history and relative to those of developed markets, partly due to moderate global economic growth and a weakening US dollar—two trends we expect to continue.

Of course, it is important to remember that we cannot expect market movements to trend in the same direction forever. While technology stocks have taken the reins in terms of driving overall performance, at least for the time being, investors cannot count on a single group or sector to endlessly dominate benchmark performance. We believe diversification remains a prudent approach to investing—perhaps even more so in times when gains are driven by a highly concentrated group of sectors or securities.

A globally-varied investment portfolio provides an investor the ability to benefit from whichever region may outperform. SEI's multi-manager approach allows an investor to gain access to emerging markets in a diversified way.

The increased weight of the technology sector in the MSCI Emerging Markets Index is not the only cause of its enhanced influence. Another factor has been the expanding availability of emerging-market exchange-traded funds, or ETFs, which are designed to offer investors passive exposure to emerging-market companies. Because inflows into ETFs reward stocks in proportion with their weights, the top-five stocks concentrated in technology names have benefitted most—and therefore have had the largest effect on Index performance.

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