Global equities: Rate cuts favour emerging markets such as China

By Perpetual Asset Management
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Fed rate cuts are not just a story for US investors – one of the biggest beneficiaries is China. Perpetual's James Holt explains

- Rate cuts see swing to emerging markets and resources
- Undervalued China shares soar
- Find out about Barrow Hanley's global equities investment solutions

Rate cuts in the US are driving a rotation towards emerging markets as investors search for stronger returns, says Perpetual's James Holt.

The US Federal Reserve cut interest rates by a larger-than-expected half a percentage point in September after a year of holding rates at their highest level in more than two decades.

This easing of monetary policy signals the end of a strong US dollar cycle that has dominated markets in recent years and should set the stage for renewed performance in undervalued emerging markets such as China.

"The big story in markets last month is the US Fed cutting rates – but what has really surprised investors is that the US cut also enabled China to follow suit with its own rate cuts," says James Holt, head investment specialist at asset manager Perpetual.

Holt represents US-based Barrow Hanley, a global leader in value investing which is distributed in Australia via Perpetual Group.

The US and China rate cuts mark a profound shift in global investment patterns with deep implications for investors, Holt says

"We live in a US dollar world and the strong US dollar of the past few years has pulled money from other parts of the world, pushing US stocks higher.

"But now we're starting to see a reversal.

"The first big rate cut might signal more cuts ahead and suddenly investors are thinking the fastest-growing, best-return place in the world might no longer be the US.

"It could be time to start taking money out of the US to find better returns elsewhere in the world.

"When markets do that, they'll also reflect on the fact that emerging markets are really, really cheap."

China shares undervalued

China's economy has struggled to recover post-COVID, leaving the Chinese stock market trading at generational lows and single digit P/E ratios.

"This isn't just the cheapest in 10 or 15 years – it's the cheapest in our careers, and we've been in this market for 25 years," says Holt.

Beijing's September stimulus package cut rates, lowered reserve ratio requirements, reduced down-payment minimums, and injected liquidity into the market.

More importantly, the government reiterated its commitment to taking the necessary policy measures to achieve its 5 per cent growth goal.

This commitment sent Chinese shares sharply higher, resulting in a 23 per cent jump in September and driving the MSCI Emerging Markets Index to a 6.7 per cent gain for the month.

Beneficiaries of the change have been leading Chinese equities like retailer JD.com, car maker Great Wall Motor Co, and insurer Ping An Insurance.

Holt argues there is more to go in Chinese policy measures to help sustain the rally. Investors should stay focussed on undervalued stocks that are great businesses and are unaffected by headwinds from government policy.

"In the Barrow Hanley Global Global share Fund, we've gone out of our way to make sure we pick Chinese stocks that are fundamentally sound but are also are in industries that Beijing wants to succeed – or at least, not in industries that the government is seeking to curtail.

"You want to curate your stocks very carefully and not hold businesses too exposed to property or other sectors that are coming under the microscope of regulatory authorities."

Potential for attractive returns

More broadly, the market is starting to broaden away from the narrow, tech-focus that has dominated recently, argues Holt.

Last month, seven of the 11 sectors outperformed the broader index as utilities and real estate benefitted from falling rates in the US and consumer, materials and industrials outperformed.

"We have been in the investment industry long enough to understand that one or two months does not make a trend.

"But the recent shifts in the market may set a longer-term trend given what we believe were clear excesses in the market not fully supported by underlying fundamentals," he says.

"Regardless, we continue to adhere to our bottom up, fundamentally driven value process, as we know over the longer term this will provide strong relative returns for our clients."

About James Holt and Barrow Hanley

James Holt is head investment specialist with Perpetual Group, which distributes Barrow Hanley Global Share Fund in Australia.

Barrow Hanley is a global leader in value investing, managing assets for clients for more than 40 years.

Barrow Hanley Global Share Fund aims to provide investors with long-term capital growth through investment in quality global shares.

Rated "Highly Recommended" by Zenith, "Recommended" by Lonsec and with a Morningstar Medallist rating of "Gold", the investment team focuses on finding value in all the right places.

Find out more here.

Barrow Hanley is distributed by Perpetual Group in Australia.

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