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Emerging markets equities: no comeback at this point

Peter Szopo

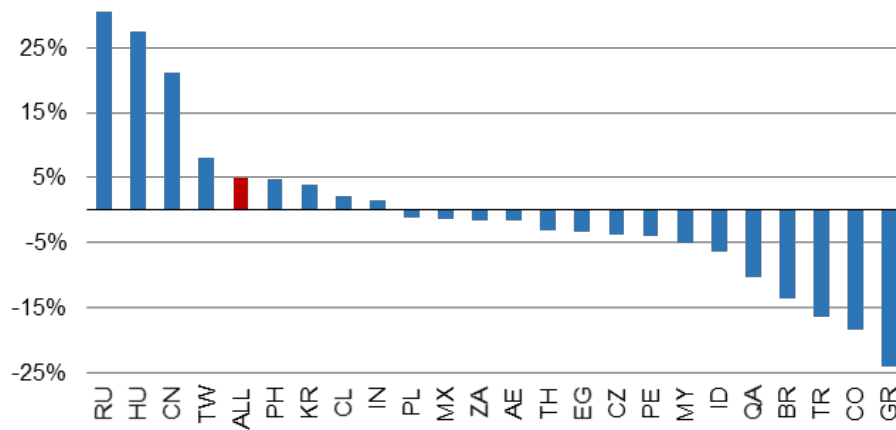


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Based on earnings expectations [emerging markets equities](#) are currently valued 27% below the price/earnings ratio of developed markets equities. The long term average of this discount is 19%. Closing the gap is a question whether the confidence of the markets in the earnings expectations is solid enough to facilitate a re-(e)valuation.

In the first four months of the year the [emerging equity markets](#) recorded the hoped-for increase, and with a plus of 14% a substantial one (year low to year high). From mid-February to the end of April they even outperformed the developed equity markets. In May, however, the situation changed, and the emerging markets fell behind again both in absolute and in relative terms. While the [MSCI EM index](#) is still on positive terrain at +5% in the year to date (in USD), this is largely due to three markets – China, Taiwan, and Russia – which together account for almost 40% of the emerging markets universe. Although at +24% Hungary has been clearly positive, it only commands a weighting of 0.2% and is thus only of marginal importance. The majority of the markets – almost two thirds – have been on negative terrain (in USD) in the year to date.

Aktienperformance seit Jahresbeginn*

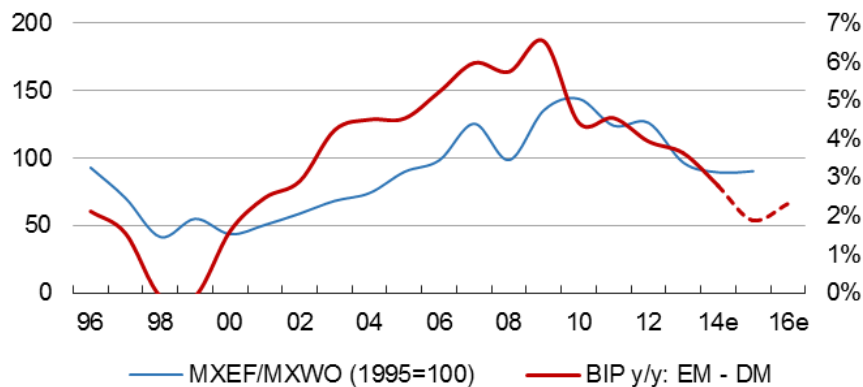


Quelle: Bloomberg; Erste Asset Management. *) 31/12/14-31/5/15

As far as the development from here on out is concerned, a number of factors are of relevance.

1. the foreseeable US [Fed funds rate](#) hike will burden the equity markets at least for a short while (even though the [long-term effects do not have to be negative](#)). This will probably affect the emerging equity markets more significantly.
2. if the [Fed](#) were to abstain from the expected hike this year, this would not help emerging markets equities either, because it would ultimately mean that the Fed expected the US economy to experience long-term stagnation.
3. the overall index of the emerging markets has soared especially in China and Russia, but in both markets the upward potential should be limited after recent rallies.
4. the positive growth gap of the emerging markets relative to the developed markets – one of the most important arguments in favour of investing in that segment – will fall to slightly above two percentage points in 2015, which from a long-term perspective is low. IMF forecasts predict a slight expansion for 2016, but the accuracy of said predictions has recently left a lot to be desired.

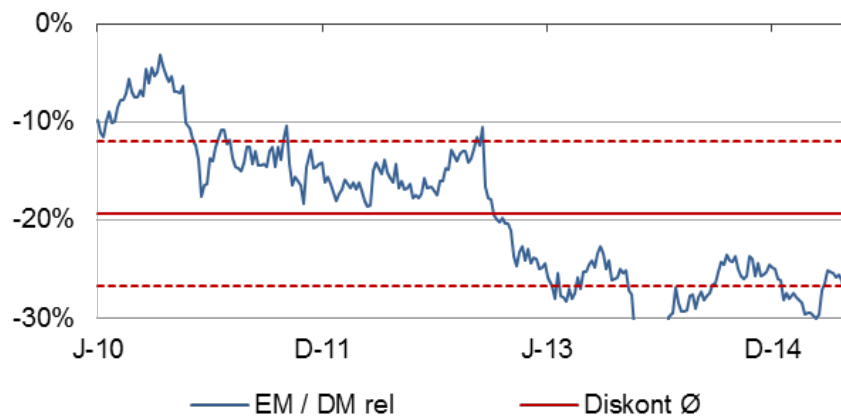
EM / DM - Wachstumsdifferenz & Aktien



Quelle: IWF; Bloomberg; Erste Asset Management - Mai 2015

In terms of valuation, the picture is mixed. The [PE-ratio](#) on the basis of expected earnings (forward 12 months earnings expectations) is currently 27% below that of the developed markets; the long-term average of this discount is 19%. On the basis of historical earnings, the discount is roughly in line with its long-term average of 23%. The question is whether the confidence of the markets in the earnings expectations of the emerging markets is solid enough to facilitate a re-(e)valuation.

EM / DM - Relative Bewertung (KGV)



Quelle: Bloomberg; Erste Asset Management - Mai 2015

In summary, another equity rally would be surprising in view of the aforementioned factors.

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Peter Szopo has worked as chief equity strategist at the Erste Asset Management since March 2015. Before he already worked as a consultant for equity fund management at Erste Asset Management for Central and Eastern European equity markets. From November 2009 to April 2013, he was head of the research department at Alfa Bank in Moscow.

After his research work at WIFO (Austrian Institute of Economic Research) from 1978 to 1990, he worked as a securities specialist in various management functions at internationally renowned investment banks. During this time he held the position of Head of Research at such institutions as Creditanstalt Investmentbank, UniCredit Bank Austria, Robert Fleming Securities, and at Bank Sal. Oppenheim.

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