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Equity performance: focus on emerging markets

Gabriela Tinti

The stock exchanges in the emerging economies and their performances have fallen short of expectations in recent years. Speculations about the weakening economy of China, the decline of commodity prices, and an appreciating US dollar have had a detrimental effect on emerging markets. However, the trust of investors in these markets has been making a comeback since 2016. In spite of Donald Trump's election victory and the fear of a US policy of protectionism, the emerging economies are currently outperforming the developed ones.

Reasons for the regained trust

According to the International Monetary Fund (IMF), the growth differential between the emerging markets and the developed markets will expand from 2.5% to 3.3% by 2021. Due to stable growth in the emerging markets – mainly, yet again, in commodity-exporting countries such as Brazil or Russia – the economists expect the economic data for 2017 to turn positive again. In 2016, said countries had still recorded negative GDP growth rates.

EM and DM: GDP Growth and Spread

Source: IMF, ERSTE-SPARINVEST

The emerging markets exchange rates have stabilised in comparison with the leading currency, i.e. the US dollar. The Mexican peso, the Turkish lira, and the South African rand are on the weaker side of this comparison. Also, the rising commodity prices are supporting emerging markets. The low inflation provides the countries with enough wiggle room to cut interest rates and thus to stimulate the economy as required. Since 2011 productivity in the corporate sector has been outgrowing real wages.

The often-predicted hard landing in China will not occur in the foreseeable future. Rather, China has been trying to change its growth model from an investment-driven export economy to a consumption and service-oriented economy. The necessary reforms in government-controlled companies are being cautiously implemented. In doing so, the reduction of overcapacities, the curbing of credit growth, and further liberalisation of the market are high priorities.

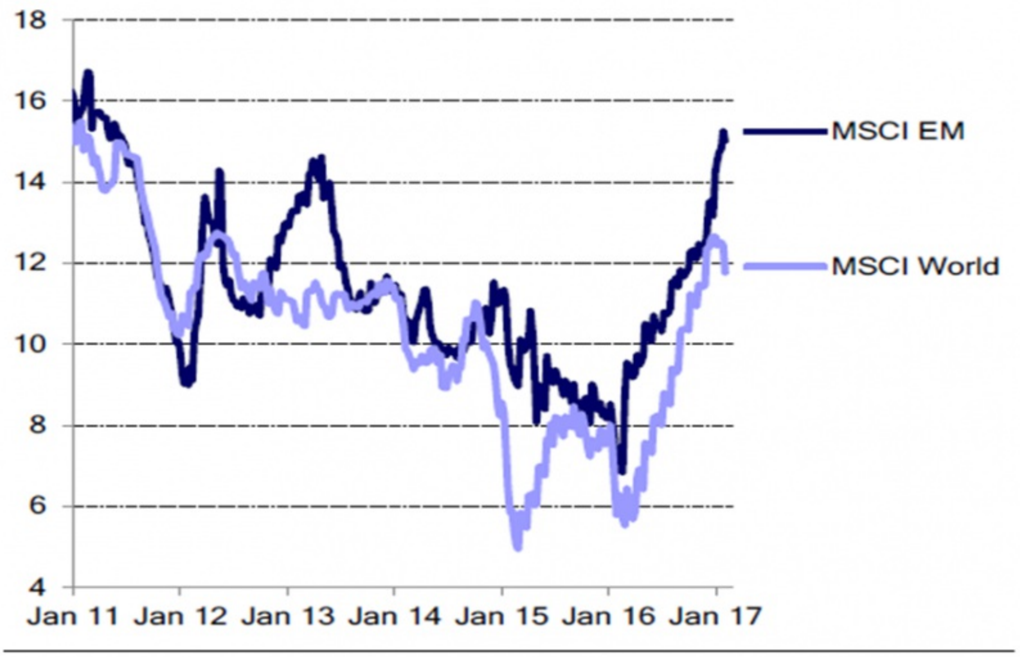
Good prospects for long-term growth

Since the turn of the millennium, average growth among emerging economies has tripled. They are and remain the growth engine of the world. This is due to better resources (e.g. commodities), healthier public budgets, and a younger demographic. The growing wealth creates a middle class and a new generation of wealthy consumers. In addition, the growing urbanisation fuels infrastructure demand. Investments in research and development (in terms of GDP) are already on an average EU level. The access of the population to education is improving while labour and the corporate sector are increasingly competitive on a global scale. Some of them are already world market leaders on the back of innovation.

Conclusion: emerging markets more attractive than developed markets

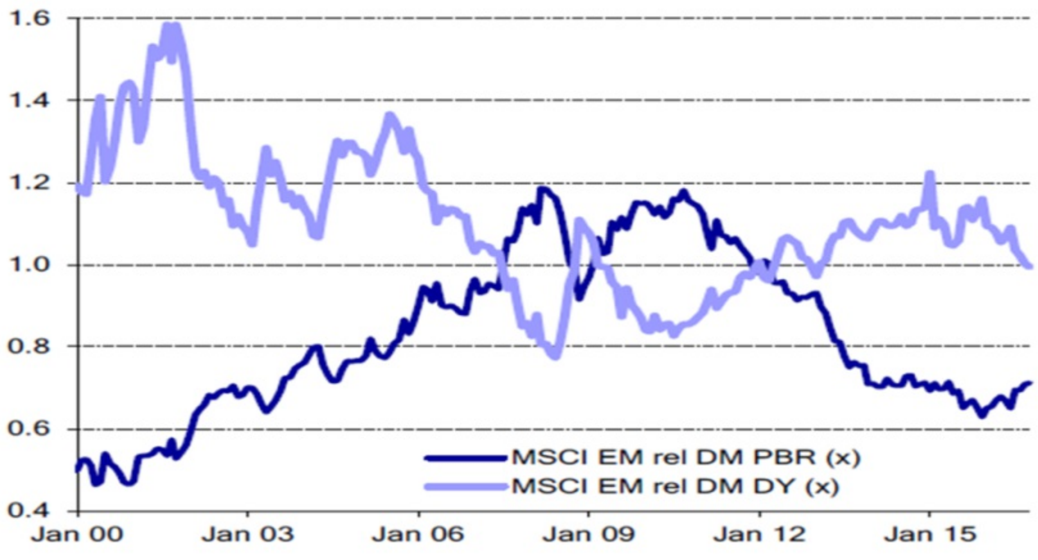
The earnings outlook for companies from the emerging markets clearly shows a positive trend; a growth rate of about 15% is expected for 2017.

MSCI EM and DM – 12m Forward Earnings



Source: MSCI, IBES, ERSTE-SPARINVEST

MSCI EM and DM – PB and Dividend Yield



Source: MSCI, ERSTE-SPARINVEST

Both the outlook and the valuation of emerging countries is attractive. The stock-picking process in emerging markets has become more selective due to the increasing degree of global interconnectedness, the effects of the announced US policies, and geopolitical risks. The continuous improvement in the area of transparency in corporate governance increases the attractiveness of emerging markets for investors.

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Gabriela Tinti has been with the equity team of Erste Asset Management/ERSTE-SPARINVEST as senior fund manager since 2008. She focuses on companies from the global emerging markets and on property companies. Gabriela Tinti has worked in finance since 1988.

At the beginning of her career, she was with a commercial bank, where she gained a wide range of experience in capital markets, retail and institutional banking, international finance, and corporate finance. In 2002 she moved to the asset management industry.