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FinanciaLounge

Emerging markets, the hunt is on for returns

The emerging markets are an investment opportunity. But it’s vital to distinguish between the different countries and keep a cool head.

Looking for interesting returns in the bond markets, and elsewhere, is becoming increasingly complicated for investors. And looking for them in the developed countries requires considerable creativity. So the question is: where can we find these potential high returns? At present the experts seem to agree in their view of **the emerging markets as the ideal terrain** for the “big hunt for returns”. But just like real-life big game hunting, the hunt for yields holds greater risks than safer and potentially less profitable investments. Knowledge, caution, precision and a cool head are, therefore, the key characteristics to achieve those sought-after returns in the exciting, but risky, terrain of the emerging markets.

DEFINE “EMERGING” — What exactly do we mean when we add “emerging” to the term “markets”? Broadly speaking, the term refers to **countries whose economies aren’t yet fully developed** and structured but which have great potential for growth. So, countries that need a lot of capital to grow but exhibit a **political and social instability** that could endanger those very investments. Very often, when people speak of emerging economies, they mention the **BRIC** countries – BRIC being the acronym for Brazil, Russia, India and China, to which a final “S”, for South Africa, was later added. In terms of indexes, however, the universe of the emerging economies can be found in the MSCI Emerging Markets index, which includes not just the five countries mentioned above but also a further 23, and measures their economic performance.


The financial district of Kuala Lumpur, in Malaysia

LOOK OUT FOR THE DIFFERENCES – The analysts agree in viewing the emerging economies as a sector where yields can be found. But they also agree in warning investors not to consider them as a uniform category. The industrialisation of China drew other commodity-producing countries into a period of shared growth in which the fundamentals of the emerging economies were essentially similar. But since then many factors have changed and within the "family" the timing and forms of growth have varied greatly. Investors aiming to avoid nasty surprises should therefore keep in mind that each country has its own unique characteristics, in spite of the common definition of "emerging market".

INDIA THE HARE, BRAZIL THE TORTOISE – One way to understand the differences between individual countries is to look at their annual GDP growth rates as recorded at September 2016. India's 7.2% stands out; in that country the campaign against tax evasion through demonetisation and a courageous fiscal reform are bearing their first fruits, after the initial shock. To underscore the differences mentioned above, the sub-continent's growth is a little faster than China's since **India**, helped in part by the widespread use of English, is focusing on services. As Madhav Bhatkuly, asset manager at GAM and an expert on the country, explains, "India is skipping the intermediate stage of heavy industrialisation. From being an agricultural economy it's becoming an economy based on services, which amount to about 60% of GDP". This growth is attracting the attention of important asset management firms. The situation in **Brazil** is profoundly different. There, the already weak growth (0.5%) is now threatened by a corruption scandal that risks toppling President Temer. Moody's, having lowered China's rating, has also brought the axe down on Brazil's debt. But this, in view of what happened in 2008 with Lehman Brothers, which retained a high rating right up to the day before it collapsed, is perhaps the least of the problems besetting South America’s biggest economy.

DEMOGRAPHICS AND PRODUCTIVITY – Population growth and increased productivity are the strong points of the emerging economies that are most interesting to investors. Here too, however, distinctions must be made. **Russia**, for example, like Japan, has an ageing population, and its economy is based on energy resources. The economy of the **Philippines**, which are also included in the “emerging” category, is linked to domestic consumption, helped by a population growth that makes it one of the world’s most favoured countries. Meanwhile, as evidence of the highly variable “emerging” panorama, **Pakistan** too is about to be included in the category.

WHO’S AFRAID OF TRUMP? – Analysts’ optimism with regard to the emerging economies is partly due to **Trump’s caution**. After calling during his campaign for walls to be built and accusing China of playing with devaluation to increase its exports, the US president is in reality greatly softening his position on Beijing. On the exports front, the enemy now seems to be the “bad” **Germany**, rather than China, where many flourishing American companies have manufacturing operations. Here too, however, we would do well to distinguish and to specify that, from among the emerging countries, Trump’s diplomatic approach in this sphere could favour Mexico. Alongside this, the emerging economies are benefiting from the recovery in global trade (+1.4% in the first quarter of 2017), as certified by the Netherlands Bureau for Economic Policy Analysis.

The Shenzhen stock exchange, one of China’s most important

CHINA – China deserves a chapter of its own. Its growth remains steady and, unlike in the past, it’s veering towards **an economy underpinned by domestic consumption**. “The Chinese economy’s transition from a model based on exports and driven by investments to an economy dictated by consumption is now a reality", explains Dawid Krige, Advisor for the Banor SICAV Greater China Long Short Equity fund. "And we expect this trend to continue for at least the coming decade or two. The Chinese government has set out its principal policies with a focus on growing consumption, maintaining currency stability and controlling debt levels. And all of these policies have been implemented successfully". However, Trump's unpredictability is a potential risk for China, along with controlling its debt levels. Two factors on which, assures Krige, "we're confident but are continuing to monitor the situation".

A COOL HEAD TO DIVERSIFY – Bearing firmly in mind that the emerging countries are highly diverse, but that sudden changes in the markets can often be a common factor, we can describe this type of investment is an opportunity for investors to diversity their portfolios. The correct price/earnings ratio for the economic cycle could help in assessing whether these markets are a good bet. By this measure, the great majority of the emerging economies are currently viewed as offering good value. The important thing is to keep calm in the face of sudden fluctuations, **accept that risk needs to be viewed from a long-term perspective** and, with the help of an expert, choose the countries, sectors and individual companies in which to invest, on the basis of your own requirements.