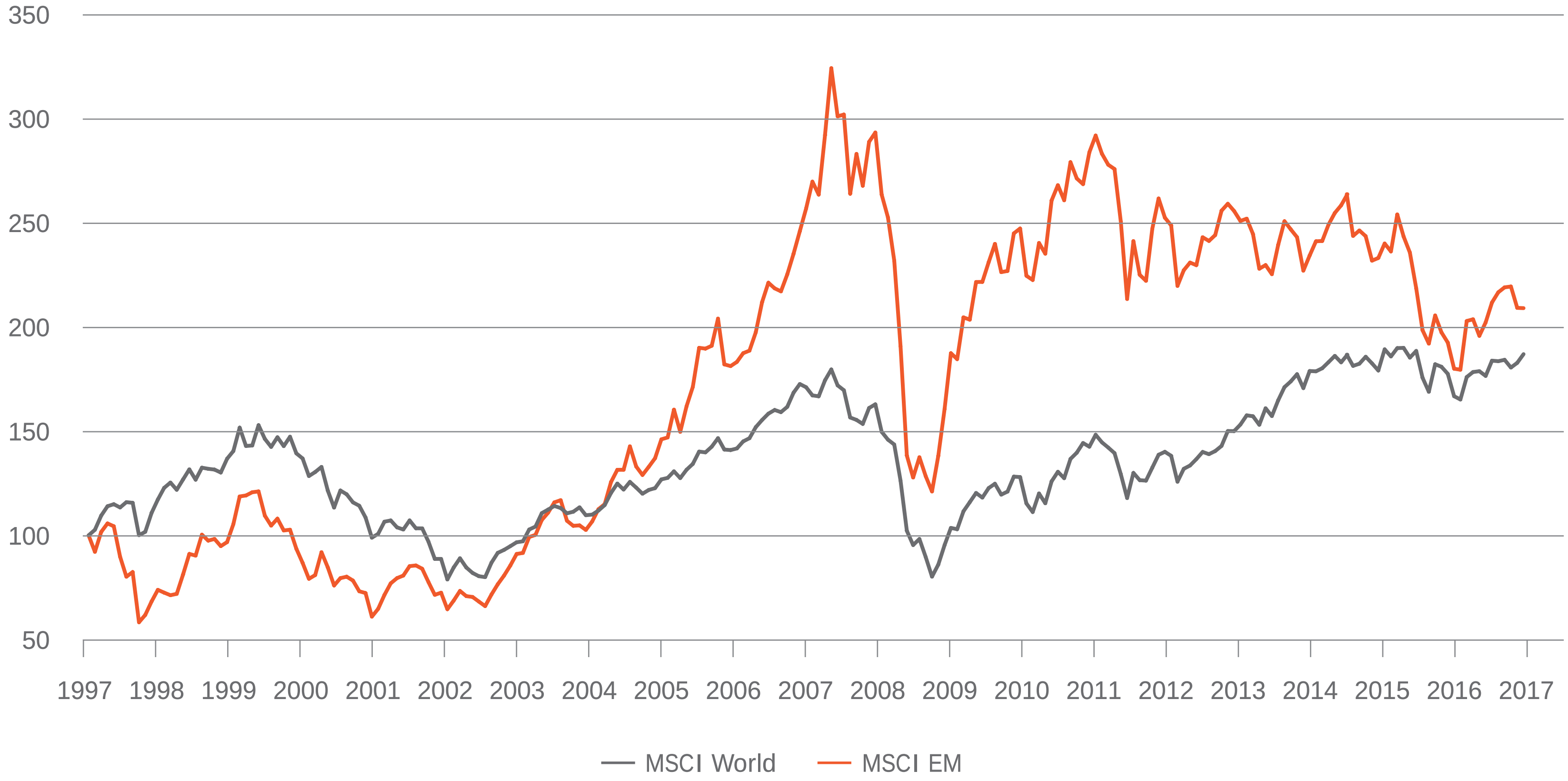
Why Invest In Emerging Markets?

Why Now?

2017

Over the long term, Emerging Markets (EM) have been a winning alternative compared to traditional Developed Markets (DM)...



Source: Bloomberg

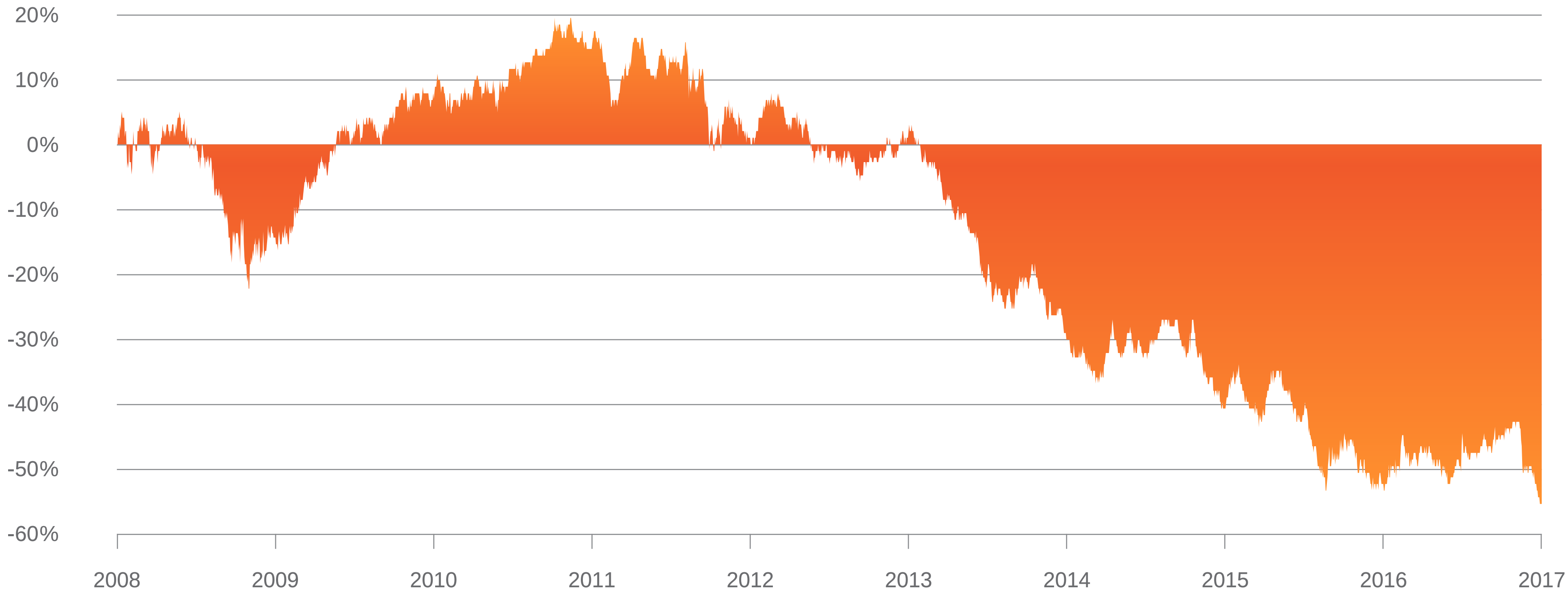
...and on an annual perspective EM have come out on top every year since 1998...

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
1st	Brazil	Jamaica	China	Dubai	Turkey	Mongolia	Mongolia	Brazil	Tunisia	Mongolia	Kazakhstan	Montenegro	Dubai	Bulgaria	Pakistan	Russia	Vietnam	Turkey	**Greece**	Oman
2nd	Kazakhstan	Latvia	Pakistan	Abu Dhabi	Egypt	Zambia	Sri Lanka	Russia	Ghana	Zambia	Peru	Kazakhstan	Romania	China H	Romania	Mongolia	Mongolia	Russia	South Korea	Turkey
3rd	Peru	Hungary	Egypt	Bulgaria	Philippines	Jamaica	Peru	Sri Lanka	Laos	Montenegro	Vienam	Dubai	Egypt	Lithuania	Bulgaria	Latvia	China	**Malta**	**Spain**	Russia
4th	Russia	**Denmark**	India	Nigeria	Estonia	**USA**	Ukraine	Peru	**New Zealand**	China	China	Egypt	Montenegro	Brazil	Estonia	Qatar	Nigeria	Indonesia	**France**	Botswana
5th	Pakistan	**Malta**	Sri Lanka	Kenya	Nigeria	Philippines	Estonia	Indonesia	Morocco	Slovenia	Cyprus	Colombia	Colombia	Thailand	Kuwait	Botswana	Latvia	South Korea	**Switzerland**	Hungary
6th	Namibia	Slovakia	Philippines	Ghana	Thailand	Indonesia	Thailand	**Norway**	Slovakia	Nigeria	Mongolia	Lebanon	Slovakia	Agrentina	Russia	Jordan	Jamaica	Mexico	**Portugal**	Mexico
7th	Hungary	**Ireland**	Argentina	Argentina	Kenya	Qatar	Indonesia	Turkey	Lebanon	Croatia	Montenegro	Saudi Arabia	Saudi Arabia	Turkey	Czech Republic	South Korea	**Denmark**	**Finland**	**USA**	**Switzerland**
8th	Morocco	**Japan**	Indonesia	**Ireland**	Pakistan	Mauritius	Chile	Argentina	Jordan	Mauritius	China H	Russia	Czech Republic	Kuwait	Qatar	Slovakia	Bulgaria	**Japan**	**Germany**	**Portugal**
9th	Colombia	Estonia	Turkey	Pakistan	**Greece**	**New Zealand**	Argentina	Chile	**Japan**	Turkey	Serbia	Kuwait	Lithuania	India	Hungary	Kuwait	Tunisia	**Greece**	Morocco	**Greece**
10th	Bulgaria	China	Qatar	**Finand**	Laos	Malaysia	Philippines	India	Qatar	Brazil	Morocco	Mongolia	Hungary	Chile	Slovakia	Nigeria	Saudi Arabia	Egypt	**Switzerland**	Kuwait

Emerging Markets   Developed Markets

Source: Bloomberg

…but since the 2008 financial crisis, the returns of EM equities has been poor…



EM has underperformed DM by 60% over the last 8 years

Source: Bloomberg

...despite the below facts.

EM, with Brazil, Russia, India, and China (BRIC) as the main players, are consistently contributing more to Global GDP. BRICs today contribute 22% to Global GDP - an all-time high. Parallel to this, DM have slowed down contributing less to Global GDP.

However, BRICs Market Cap only represents 13% of Global Equity Market Cap. Since 2008, EM have lagged as investors rushed into buying bonds and DM equities. Today, EM are at a very fascinating junction – valuations are attractive compared to DM whilst providing investors higher dividend yield and earnings growth. This dislocation creates a unique opportunity.

Source: Bloomberg

Let’s take a closer look at the most interesting triggers which could well support positive stock market returns for many years to come:

1. **Young & Growing Markets**
2. **Economic Growth**
3. **Equity Valuations**
4. **Trade Wars**
5. **Resources & Commodity Prices**
6. **Borrowing Costs**
7. **Portfolio Diversification**

1 Young & Growing Markets

Most investors consider EM risky but do not ponder on the fact that today´s DM (such as Italy, Spain) not long ago were “emerging” or even “frontier” themselves. Many of the developing nations are catching up and in the process companies can deliver higher returns in this high growth environment.

Why not DM Equities?

- Ageing Population
- Little or no Real GDP Growth
- High and Rising Sovereign Debt levels
- Reliance on EM Trade Balance
- Rising Inflation

Why EM Equities?

- Falling Inflation
- Solid Currencies
- Growing Exports
- Strong Local Demand
- Growing Consumption
- Relatively Low Debt Levels

2 Economic Growth

DM are now projected to grow by 1.9% in 2017 and 2.0% in 2018.

The primary factor underlying the strengthening global outlook over 2017 to 2018 is, however, the projected pickup in EM growth

EM growth is currently estimated at 4.1% in 2016, and is forecast to reach 4.5% for 2017

A further pickup in growth to 4.8% is estimated for 2018

The table shows China and India as key contributors to global EM growth. A slowdown in these countries could become a key risk

	Estimates		Projections	
	2015	2016	2017	2018
World Output	**3.2**	**3.1**	**3.4**	**3.6**
DM	**2.1**	**1.6**	**1.9**	**2.0**
US	2.6	1.6	2.3	2.5
Euro Area	2.0	1.7	1.6	1.6
Germany	1.5	1.7	1.5	1.5
France	1.3	1.3	1.3	1.6
Italy	0.7	0.9	0.7	0.8
Spain	3.2	3.2	2.3	2.1
Japan	1.2	0.9	0.8	0.5
UK	2.2	2.0	1.5	1.4
Canada	0.9	1.3	1.9	2.0
Other DM	2.0	1.9	2.2	2.4
EM	**4.1**	**4.1**	**4.5**	**4.8**
CIS	-2.8	-0.1	1.5	1.8
Russia	-3.7	-0.6	1.1	1.2
Excluding Russia	-0.5	1.1	2.5	3.3
Emerging Asia	6.7	6.3	6.4	6.3
China	6.9	6.7	6.5	6.0
India	7.6	6.6	7.2	7.7
Asean	4.8	4.8	4.9	5.2
Emerging Europe	3.7	2.9	3.1	3.2
Latin America and Caribbean	0.1	-0.7	1.2	2.1
Brazil	-3.8	-3.5	0.2	1.5
Mexico	2.6	2.3	1.7	2.0
Middle East and North Africa	2.5	3.8	3.1	3.5
Saudi Arabia	4.1	1.4	0.4	2.3
Sub-Sahara Africa	3.4	1.6	2.8	3.7
Nigeria	2.7	-1.5	0.8	2.3
South Africa	1.3	0.3	0.8	1.6

Source: Bloomberg

3 Equity Valuations

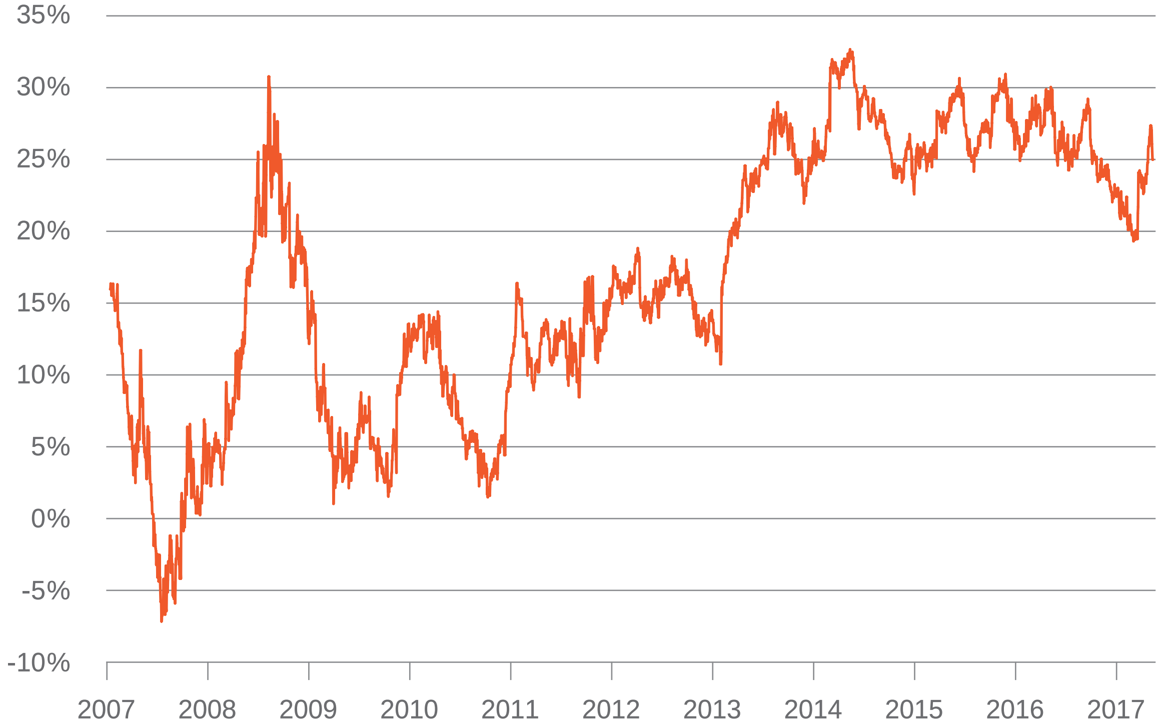
Valuations in EM equity and debt remain compelling

The cyclically adjusted P/E multiple is now trading at 12.8x. This is a significant discount to its long-term average of 25x

In contrast, the US S&P 500 index is trading at 23.4x cyclically adjusted earnings, within a whisker of its long-term average of 23.6x

Today EM equities trades at a 25% discount to DM equities

Discount - P/E Ratio (EM vs DM)



Source: Bloomberg

4 Trade Wars

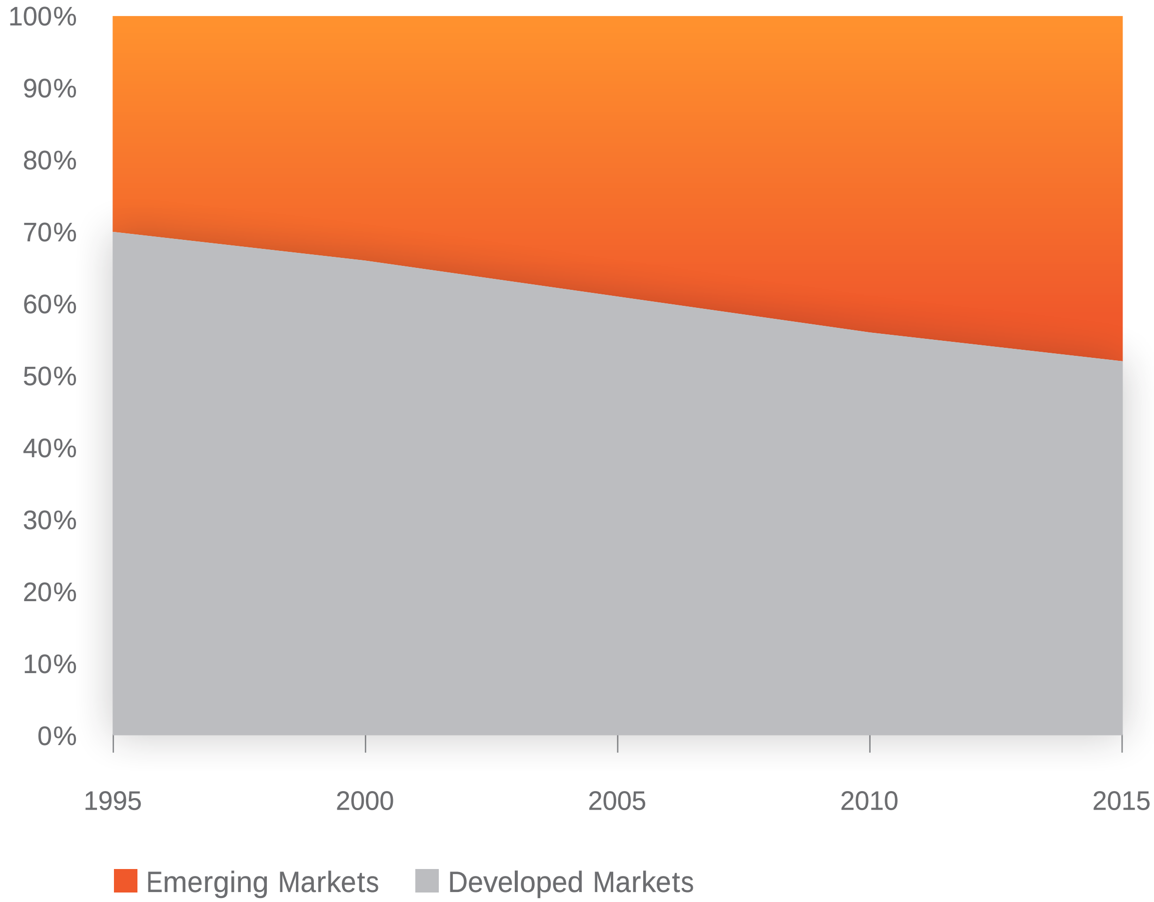
DM share of global trade moved from 70% in 1995 to only 52% in 2015

During 1995 to 2005, DM trade growth was only 24% dependent on EM while over the next 10 years it was 53%

As long as intra-EM policies are not affected, EM may ironically become even bigger winners as they further increase their intra-EM trade and substitute DM products

Trump's election may slow down this shift towards EM trade, especially for Mexico and China

Share of World's Trade



Source: Bloomberg

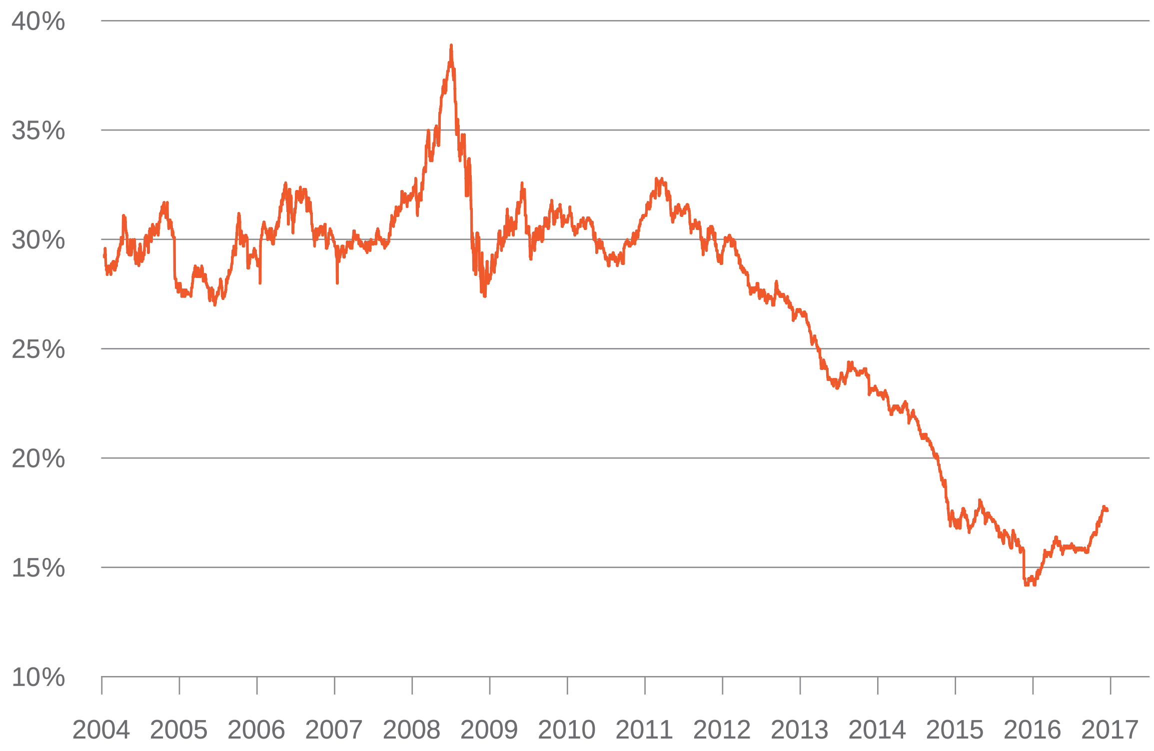
5 Resources & Commodity Prices

Historically EM stocks have been highly correlated to, or dependent on, commodity prices. In fact, energy and material stocks used to represent 30-40% of global EM market cap in 2004

This dependency has now come down to 15% due to a stronger domestic consumption which has driven up industries such as consumer staples, financials, IT and industrials

A key risk could be a slowdown in the consumer story – should this materialize, correlation and dependency on commodity prices would rise

MSCI EM Energy & Materials Market Cap as a % of EM Market Cap

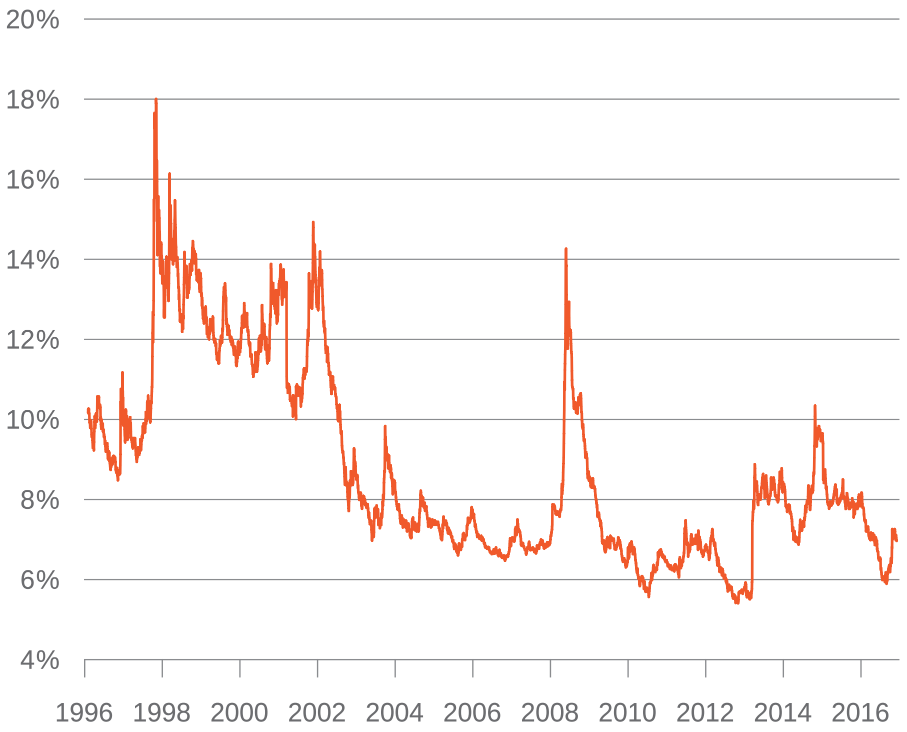


Source: Bloomberg

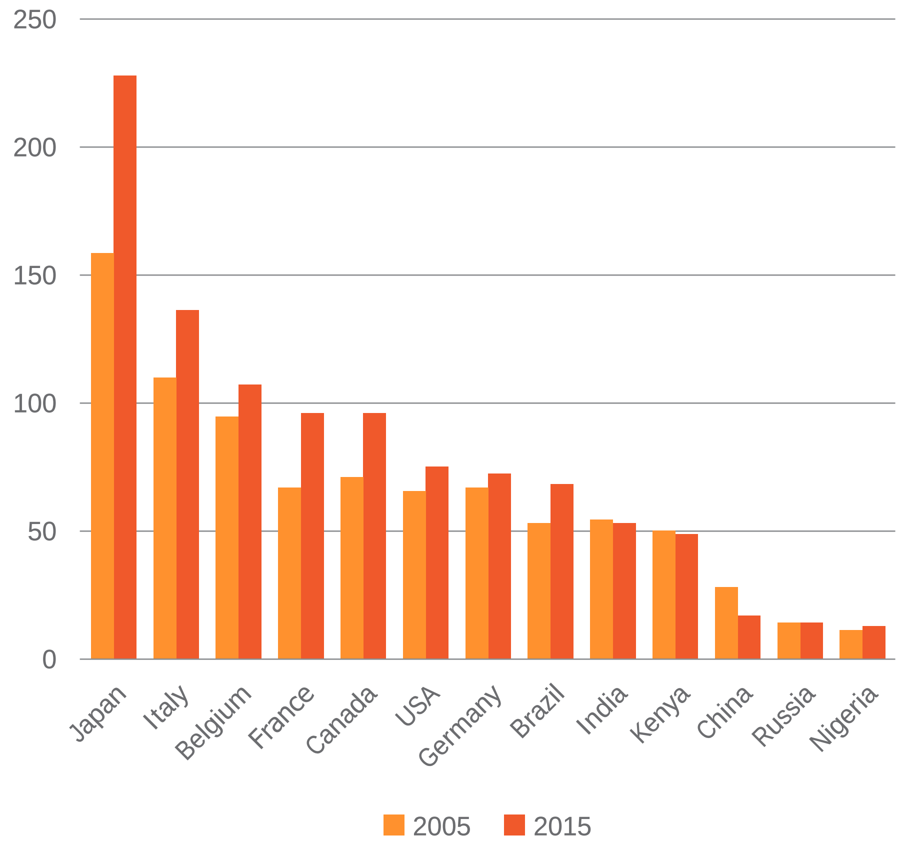
6 Borrowing Costs

Higher debt levels, as a % of GDP, will continue to hamper growth in DM

EM Sovereign Borrowing Costs are at Very Low Levels

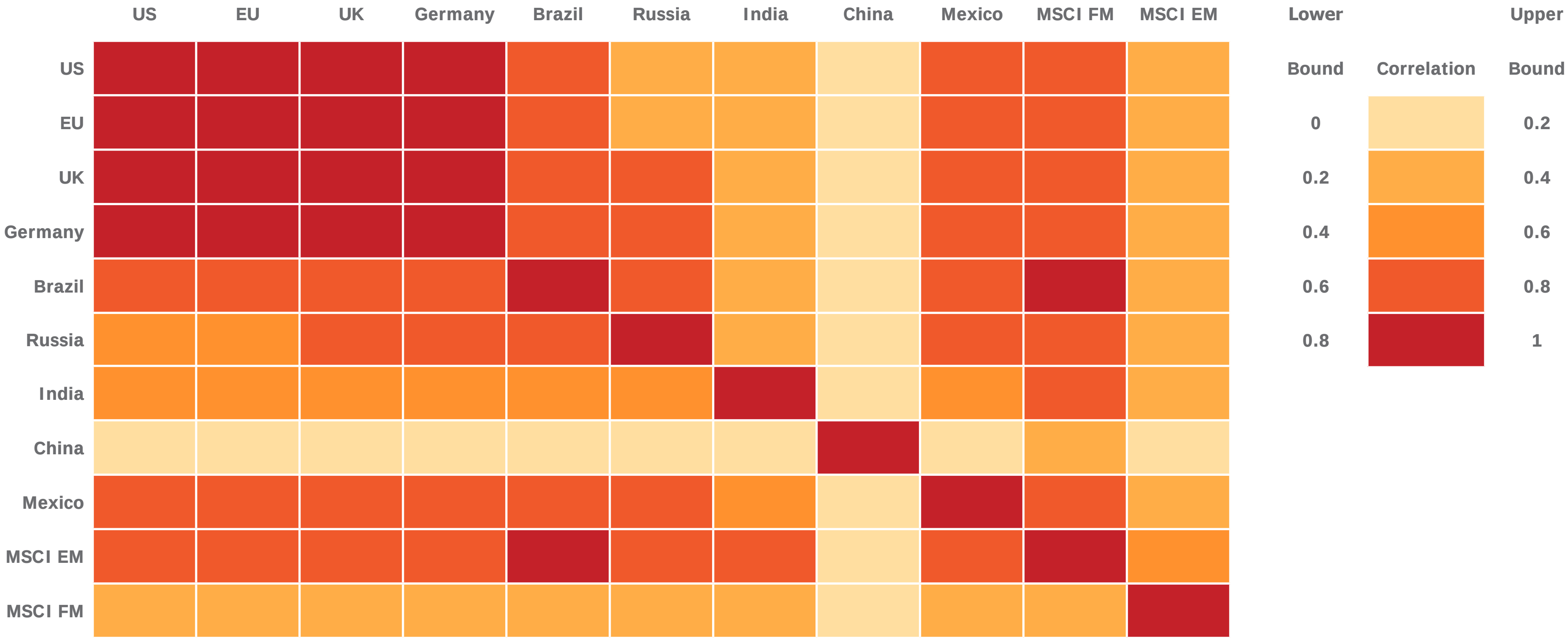


Government Debt as a % of GDP



Source: Bloomberg

7 Portfolio Diversification



DM equities remain highly correlated to each other (>0.8). EM equities still provide relatively uncorrelated returns for equity investors

Source: Bloomberg

Conclusion

We believe it is challenging to time markets. Owning inexpensive assets with significant growth potential over a long term is the way to go. Maintaining a portfolio of EM stocks allows increased diversification benefits and gives investors access to the world's fastest growing economies.

FMG is dedicated to affording investors efficient and multiple ways to gaining exposure to these markets. Due to compelling valuations and attractive growth prospects we highly recommend being overweight EM at this time.

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