

Emerging Markets, Out of Favour?

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One of the equity sectors that has enjoyed a real boom time over the past few years has been the emerging markets sector, but whilst major stock markets in North America, Europe and the UK saw equities storm higher at the start of 2013, emerging markets were left trailing.

Emerging Markets have always been a slightly nebulous sector with who qualifies depending greatly upon who you ask. The International Monetary Fund has 24 countries classed as emerging markets. MSCI Barra which creates and maintains global stock market indices has 23 countries in its Emerging Market category, with Greece shortly to be joining the club, but only 15 countries are present on both lists. The broad consensus is that Emerging Markets are countries with fast growing economies which are not yet on a par with the more developed markets.

For investors emerging markets present an ideal opportunity to gain access to stocks with high capital growth potential in economies that are less correlated to global equity markets. Whilst direct equity investment in emerging markets remains difficult for those outside of institutions there are numerous investment funds, both actively managed or passively tracking an underlying index which can offer investors access to either the global emerging markets space or more specific regions or sectors.

It is possible that one of the drivers of growth in many of the emerging markets over the past few years has turned into the main artificer of their downfall. With many emerging economies relying upon a large resources sector to generate revenue, falling commodity prices will have damaged the growth prospects of these countries in the eyes of investors. The largest emerging economy, China, has also provided a drag on the sector amongst reports of slowing growth and a reduction in industrial demand hurting not only China itself but Emerging economies particularly in Asia where many countries see a large proportion of their demand coming from the Chinese mainland.

Another factor which has detracted from the value of emerging economies has been concerns over governmental stability. These concerns have unfortunately been borne out by the recent civil unrest in Brazil, Turkey and most notably Egypt.

Emerging markets have also been possibly the worst hit by the potential

phasing out of the quantitative easing, or the buy of bonds, by the US government, MSCI's index of Emerging Market stocks has fallen 9.6% since US Federal Reserve Chairman Ben Bernanke first commented on the potential withdrawal of Quantitative Easing on 22nd May. Should this practice cease, or at least slow, analysts predict it will result in a rise in yields on US bonds, thereby having a knock on effect that will reduce the incentive for investors to place their money in emerging markets which will not only effect emerging market debt and equity prices in the short term but also the longer term growth prospects for the smaller economies.

The continued threat of civil unrest and the phasing out of the US asset purchase plan has seen Emerging Market debt sales slide to their lowest level for five years. Equity valuations for emerging market stocks have also fallen with equities now showing valuations which have not been seen in developed markets for over a decade.

Whilst the recent underperformance of the Emerging Markets sector has seen the sector fall out of favour with investors it has also resulted in some attractive valuations. We continue to believe that over the medium to longer term, subject to improving standards of governance, Emerging Markets will return to favour with investors.



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