Emerging Markets are set to continue

their long-term outperformance

DENKER CAPITAL

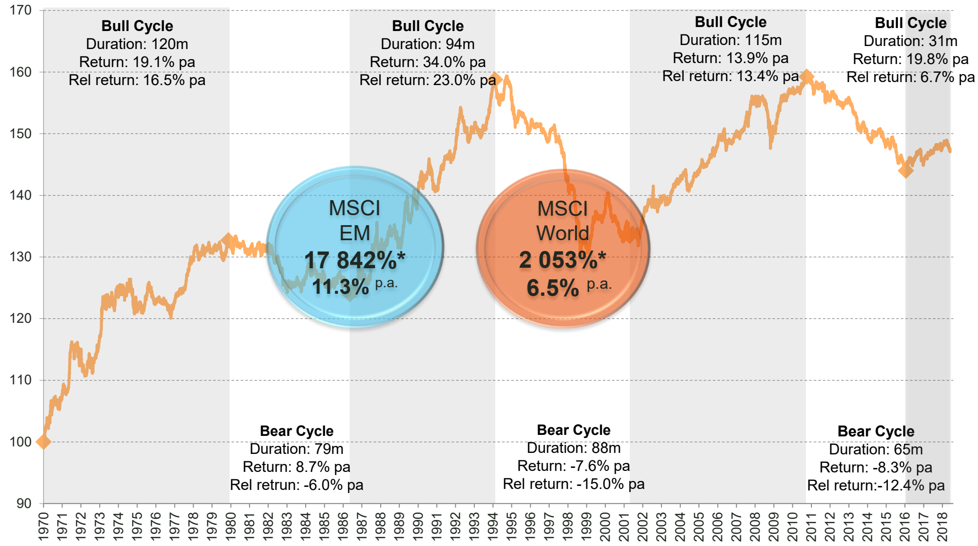
Although emerging markets (EMs) have outperformed developed markets by a substantial margin over time, we have recently seen some underperformance in EMs. This can be ascribed to investor fears brought on by geopolitical events. However, it's important to remember that similar geopolitical events have occurred in the past – and EMs have outperformed developed markets over the long term, regardless. We believe that there is a significant disconnect between the fundamentals of EM companies and the macro noise reflected in the media, and that there are still long-term growth opportunities to be found in EMs.

EMs outperform developed markets over time, despite volatility over the short term.

Although EMs are riskier and more volatile than developed markets, they have outperformed developed markets dramatically since 1970. We calculated that if you had invested $1 million into the MSCI Emerging Markets Index in 1970, it would now be worth $179 million. This is $158 million more than what you would've earned from the MSCI World Index!

> "There is a significant disconnect between the fundamentals of EM companies and the macro noise reflected in the media, and that there are still long-term growth opportunities to be found in EMs"

Figure 1: Emerging markets have outperformed developed markets substantially over time (relative equity performance index in log terms)



Source: FactSet, DataStream, Bloomberg, Goldman Sachs Global Investment Research
**Cumulative returns in US dollars, as at 31 July 2018.*

Looking past fear and focusing on company fundamentals reveals that EMs remain attractive.

Many EM companies are reporting robust growth in revenue and earnings, on the back of improving consumer sentiment. But because of the poor macro outlook and geopolitical events, share prices are being driven down and quality companies have become undervalued. This dislocation presents investors with great opportunities for selective stock picking and to invest in quality companies that were previously too expensive, and in so doing, continue to reap the benefits of EM outperformance.

The reasons why EMs outperform over time represent long-term factors that carry a lot of weight.

1. They are long-term drivers of growth.

EMs are under-represented in equity markets compared to their contribution to global GDP.

As countries move up the development curve, their stock markets typically grow. This results in a rising ratio of market capitalisation to GDP. It is interesting that the IMF expects EMs' share of global GDP to increase at a growing pace going forward.

There are structural drivers of growth in EMs.

• An abundance of resources and human capital

The number of people and resources available in EMs is generally much higher than in developed markets, allowing more room for growth.

• Younger and faster-growing populations

EMs typically have populations that are much younger and growing at a faster rate, which further supports future growth, whereas the majority of developed market populations are ageing. The challenge that this represents is not only the number of older persons but also the ratio of older to younger people. An older and shrinking workforce places more demands and pressure on markets, such as an increasing demand for healthcare infrastructure and a decline in economic capacity and growth.

• Rapid urbanisation

The established urban areas that represent developed markets tend to dominate global economic activity (even more than the high population levels would suggest), which is evident in their considerably higher disposable incomes and wealth. Average urban incomes are roughly three times those of their rural counterparts in emerging countries like China and India. These income gaps, and the fact that urbanisation in EMs is expanding, show that there is scope for urbanisation to be a driver of growth in these countries. There is a lot of capacity available for urbanising EM cities to attract skilled workers, productive businesses and economies of scale that enable workers to be more productive and reduce the costs of supplying basic services.

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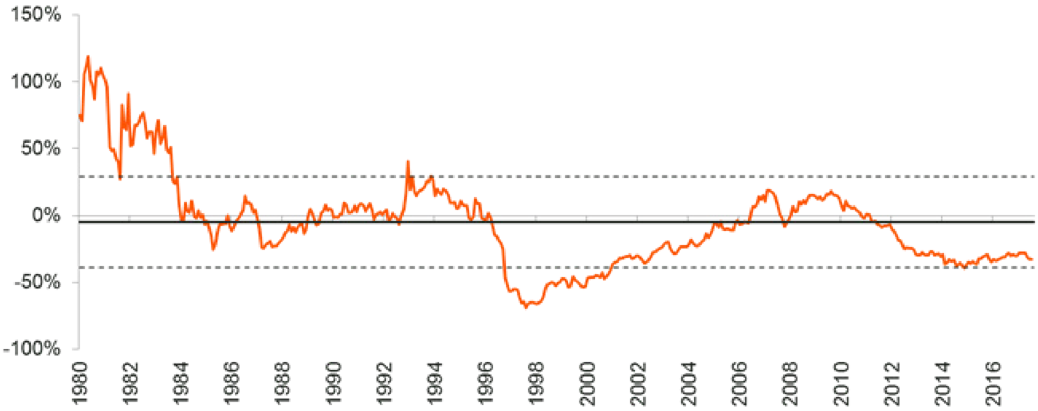
2. Their valuations are attractive.

EMs are still attractively valued. This enables investors to potentially achieve superior long-term returns if they can identify and exploit the right investment opportunities.

Figure 2: EMs are attractively priced compared to developed markets (price to NAV)



Source: FactSet, as at 31 July 2018

Written by

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Long-term investors who can withstand short-term volatility should reap considerable long-term benefits when investing in EMs.

The attractive valuations and company fundamentals of EM companies, coupled with an abundance of natural resources, large and growing populations, and rapid urbanisation, should continue to support the strong growth we've seen in EMs. This gives patient, long-term investors the opportunity to earn attractive risk-adjusted returns, while diversifying their portfolios.