

Schroders



# Schroders Emerging Markets Lens: Equity

## Strategic Research Unit

November 2022

Marketing material for professional investors or advisers only.

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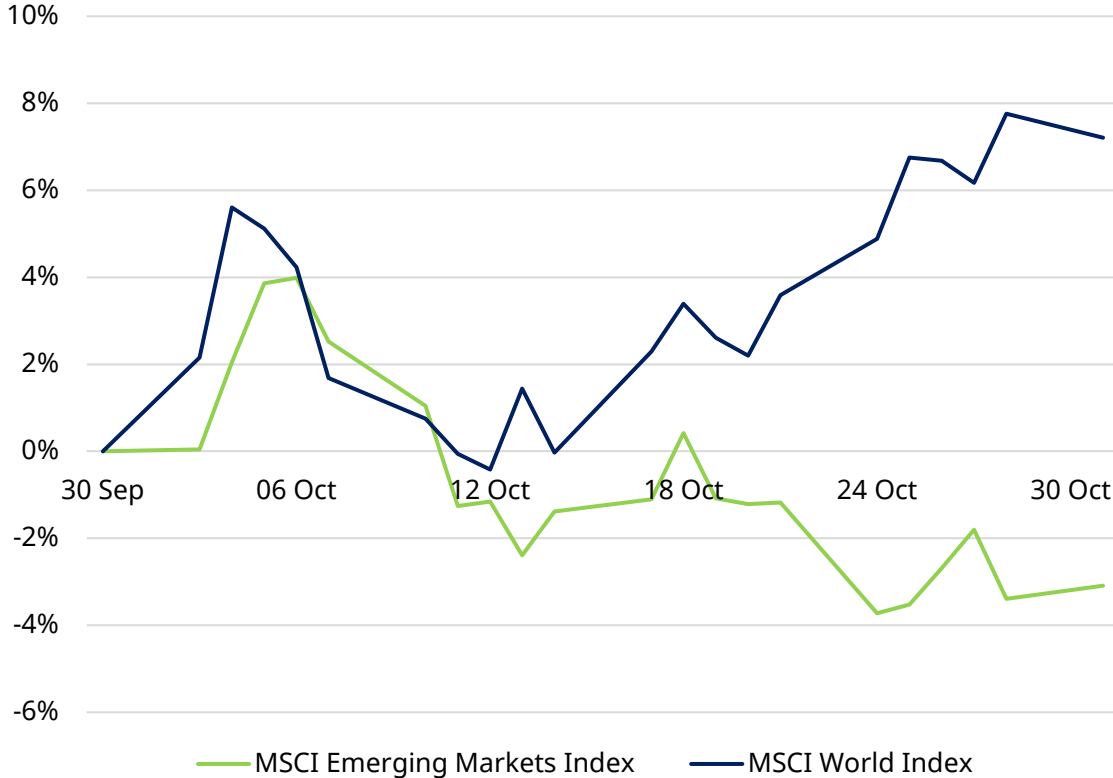
# Summary

- Emerging market (EM) equities fell -3% in October, underperforming developed markets (DM) by 10%. However, this was primarily due to weakness in China and Taiwan.
- Chinese equities corrected as the 20<sup>th</sup> National People's Congress reinforced President Xi's authority and did not indicate any near term end to the Zero-Covid policy. New US export controls on semiconductor manufacturers, which will restrict Chinese companies access to advanced chips, also weighed on sentiment.
- Year-to-date, commodity-producing Latin American and Middle Eastern markets have been the top performers. China is the weakest index market while several Eastern European markets are also sharply lower.
- EM equities as a whole are undervalued on both a forward price-earnings and price-book basis when compared with the historical median. On a dividend yield basis, EM has reached a post-GFC high. Aggregate earnings expectations have continued to fall though, with further downside likely in the coming months.
- There remains considerable variability between sector valuations in EM. Growth sectors in general remain much more expensive than value sectors. EM equities are cheaper than developed market (DM) equities, but the difference is not extremely large, especially on a sector neutral basis.
- Valuations in Asia have become more attractive in some markets. Latin America remains the cheapest region.
- A decade of US dollar appreciation has weighed on EM equity returns. Most EM currencies have depreciated in real terms, implying emerging value, although the extent varies significantly.

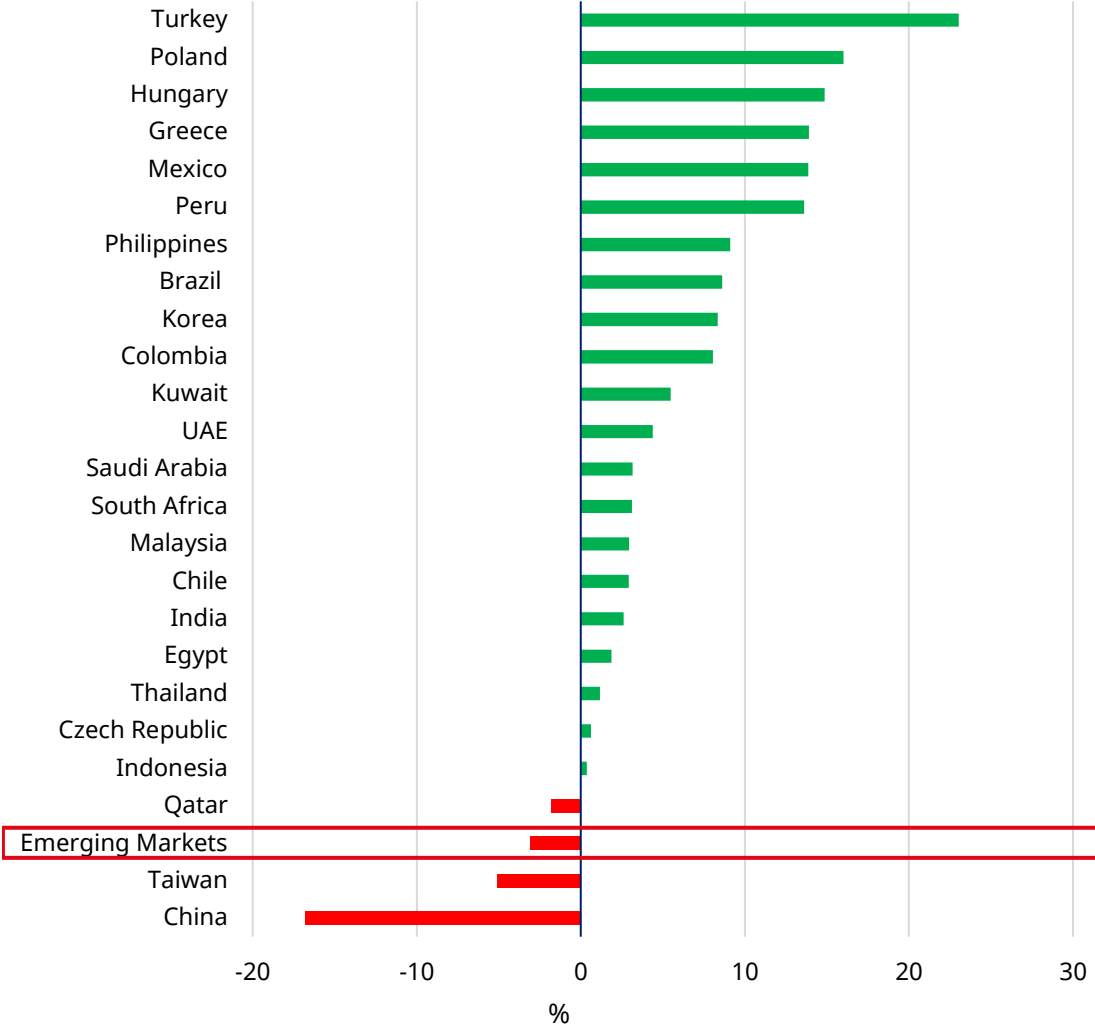
# China and Taiwan dragged down EM vs DM

...but most other EM registered gains

October emerging and global equity market returns



Past performance is not a guide to future performance and may not be repeated.  
 Total return, US dollars  
 Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit, as at 31 October 2022.

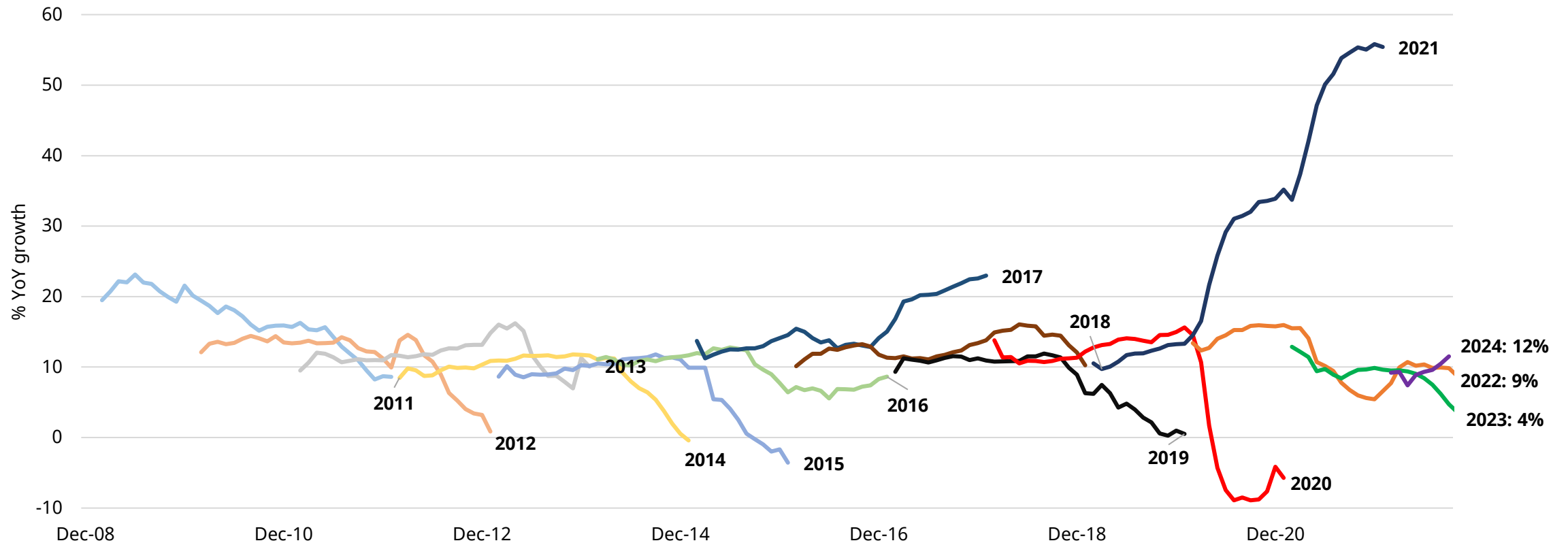


Past performance is not a guide to future performance and may not be repeated.  
 Percentage total return. US dollars.  
 Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit, as at 31 October 2022.

# What to watch – EM earnings expectations

EM earnings expectations for 2023 have been trending down

## Evolution of consensus annual EM EPS growth forecasts



Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022  
**Past performance is not a guide to future performance and may not be repeated.**

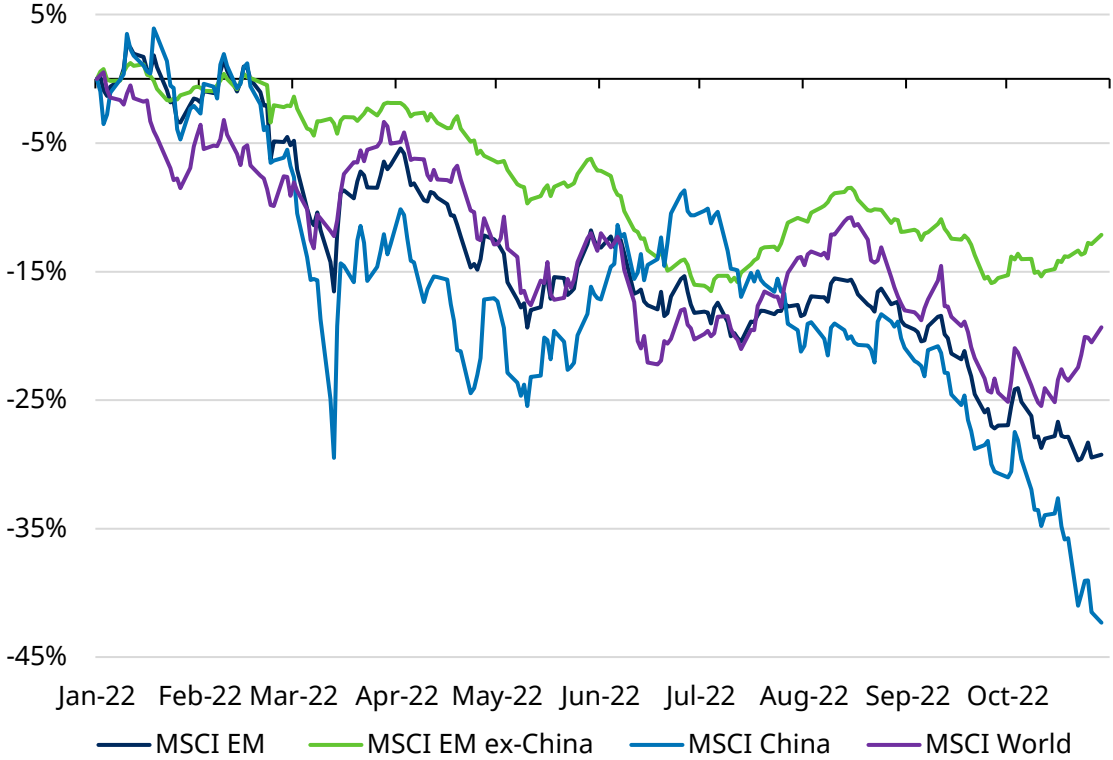


## Emerging market equity performance

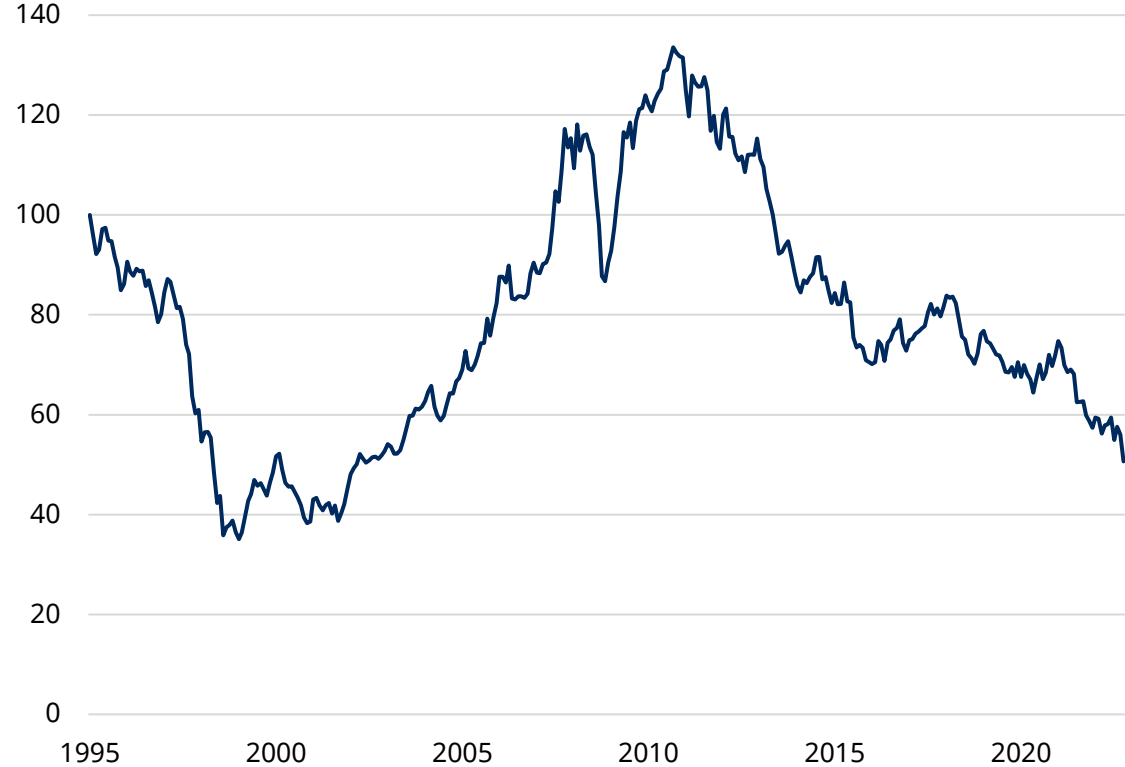
# EM equities have underperformed DM since 1995...

...and lag DM YTD in 2022

### Returns of EM equity regions (total return)



### EM vs DM (total return, rebased to 100)

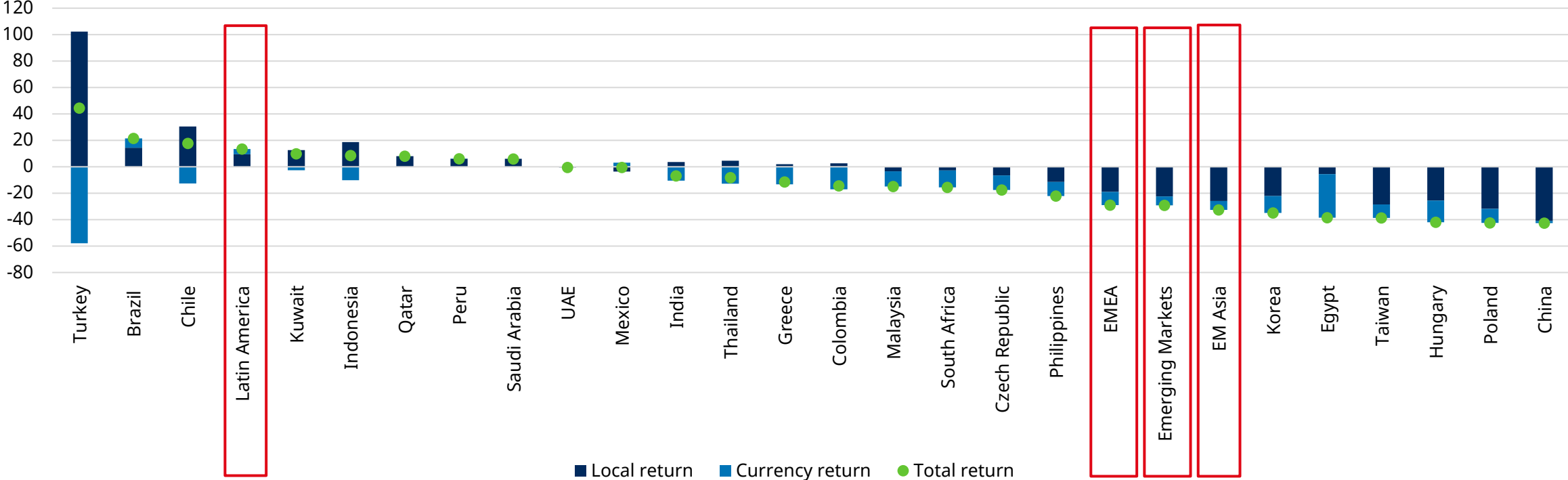


**EM equities are firmly down YTD and lag DM, dragged down by weakness in China**

**Past performance is not a guide to future performance and may not be repeated.**  
Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022. All returns in USD terms.

# Significant variability in EM performance

## 2022 YTD returns in EM equity markets



China is the weakest index market, while several Eastern European markets have taken a hit. Commodity exporters have outperformed YTD. Latin America continues to lead.

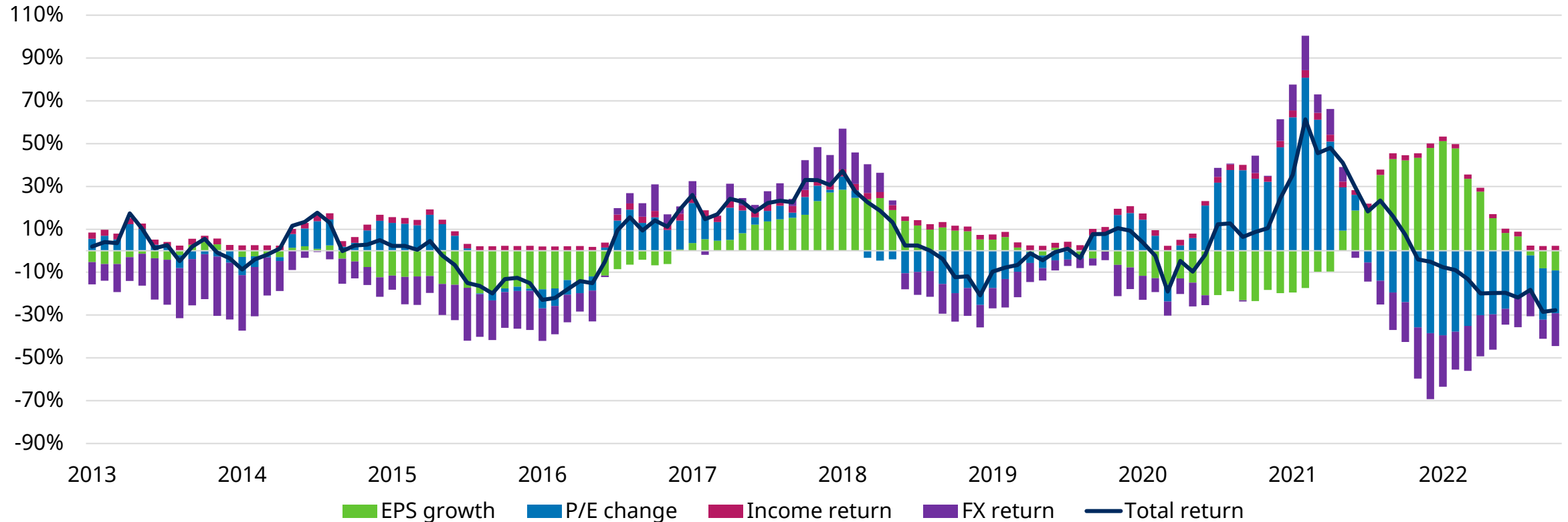
Past performance is not a guide to future performance and may not be repeated.  
 \*EMEA is Europe, the Middle East and Africa  
 Source: Schroders, Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.



# Decomposition of EM equity returns

Return drivers vary over time

## Components of the MSCI Emerging Markets Index 12-month total return



Rolling 12-month total return is negative due to contracting P/E multiple, currency losses and EPS growth

Past performance is not a guide to future performance and may not be repeated.

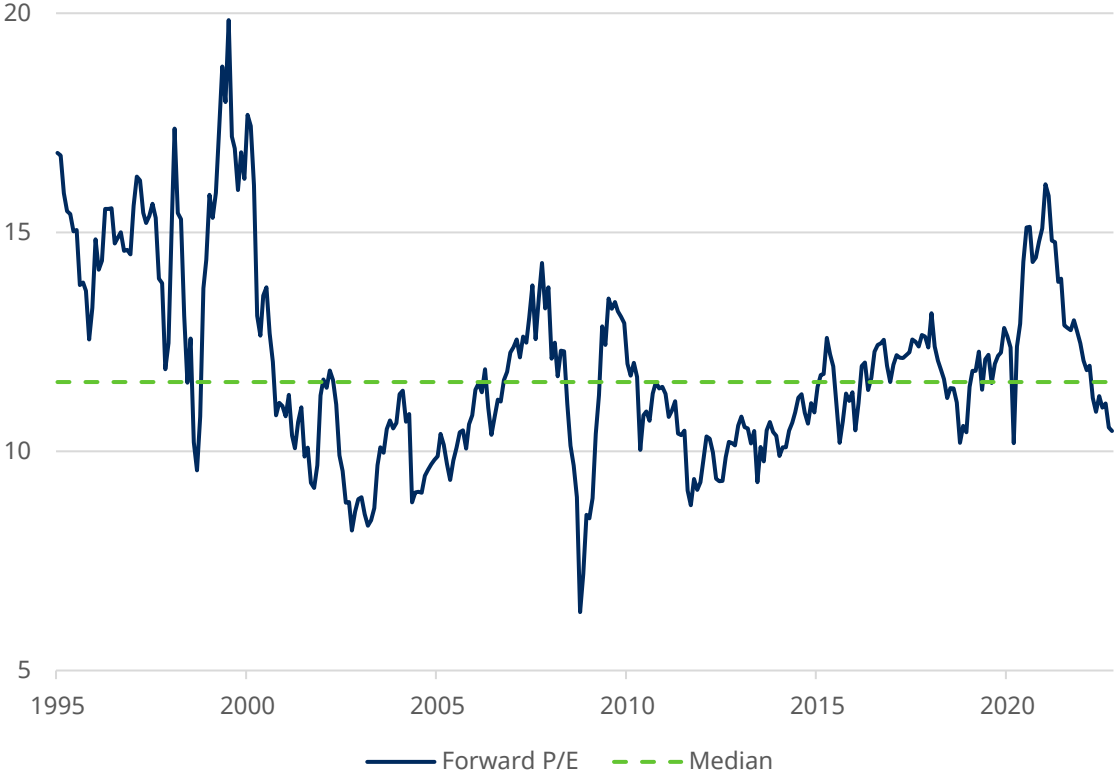
Source: Schroders, Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.



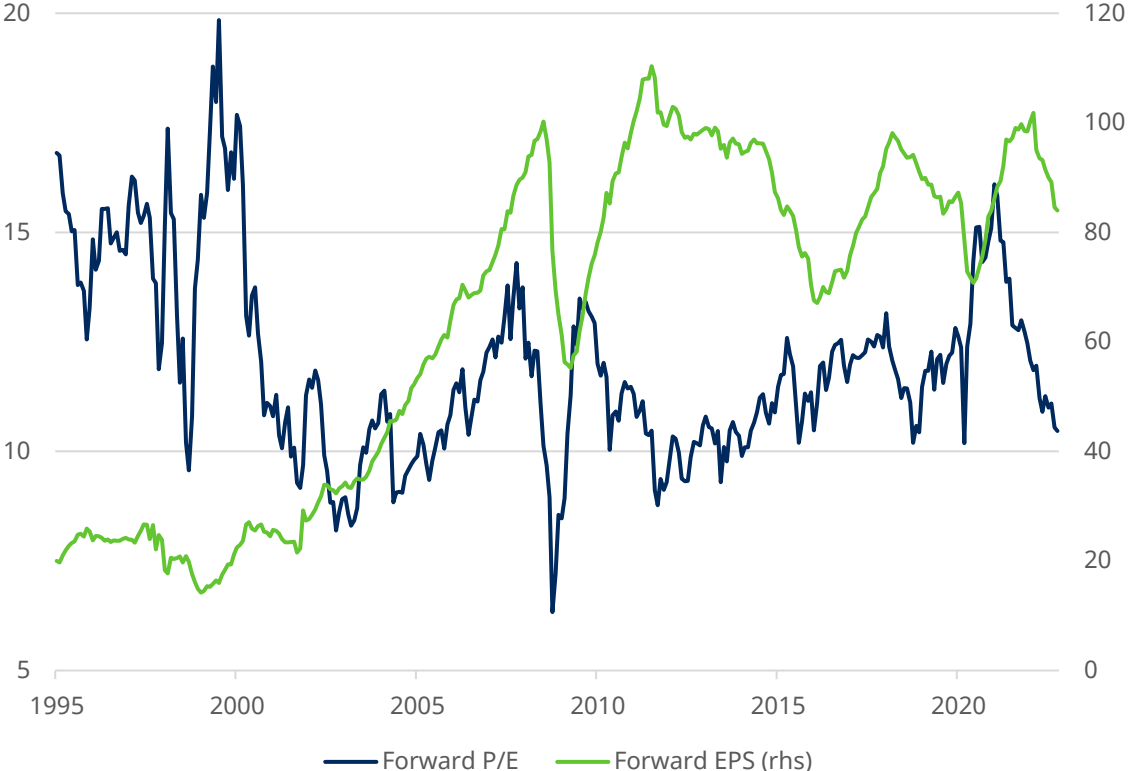
## Emerging market equity valuations

# EM forward P/E has fallen below the historical median

### The MSCI EM Index 12-month forward P/E



### The MSCI EM Index 12-month forward P/E and EPS



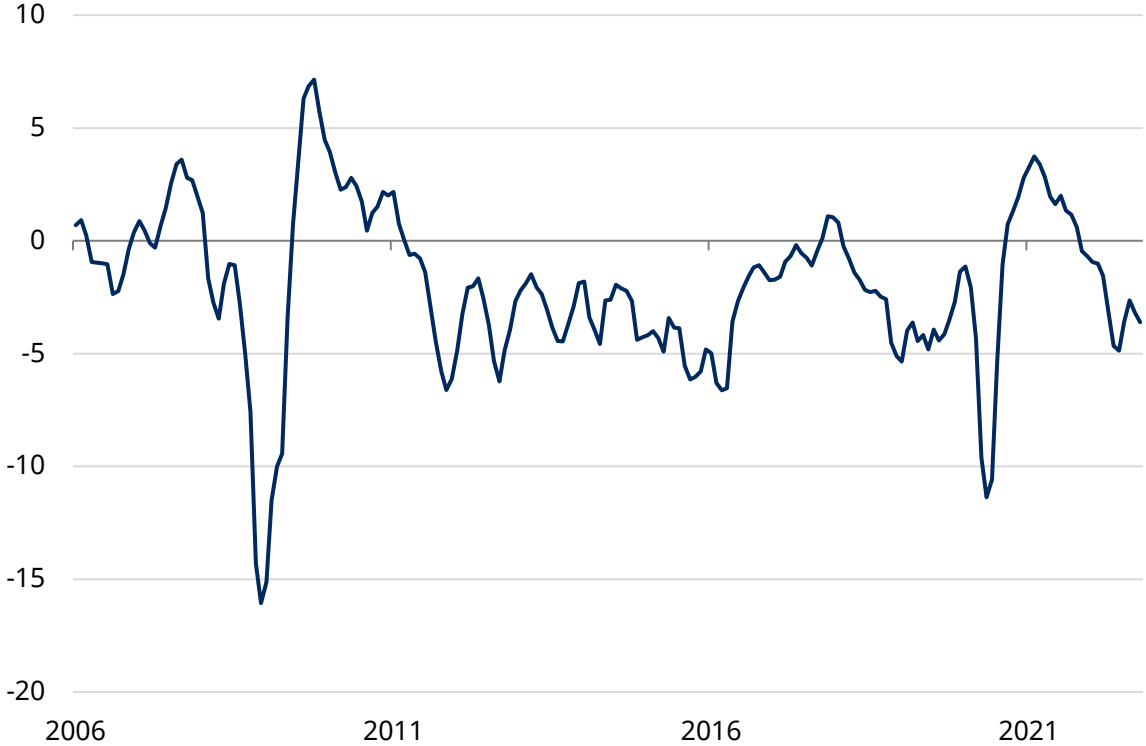
**EM equities are undervalued after being overvalued for the last two years**

Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

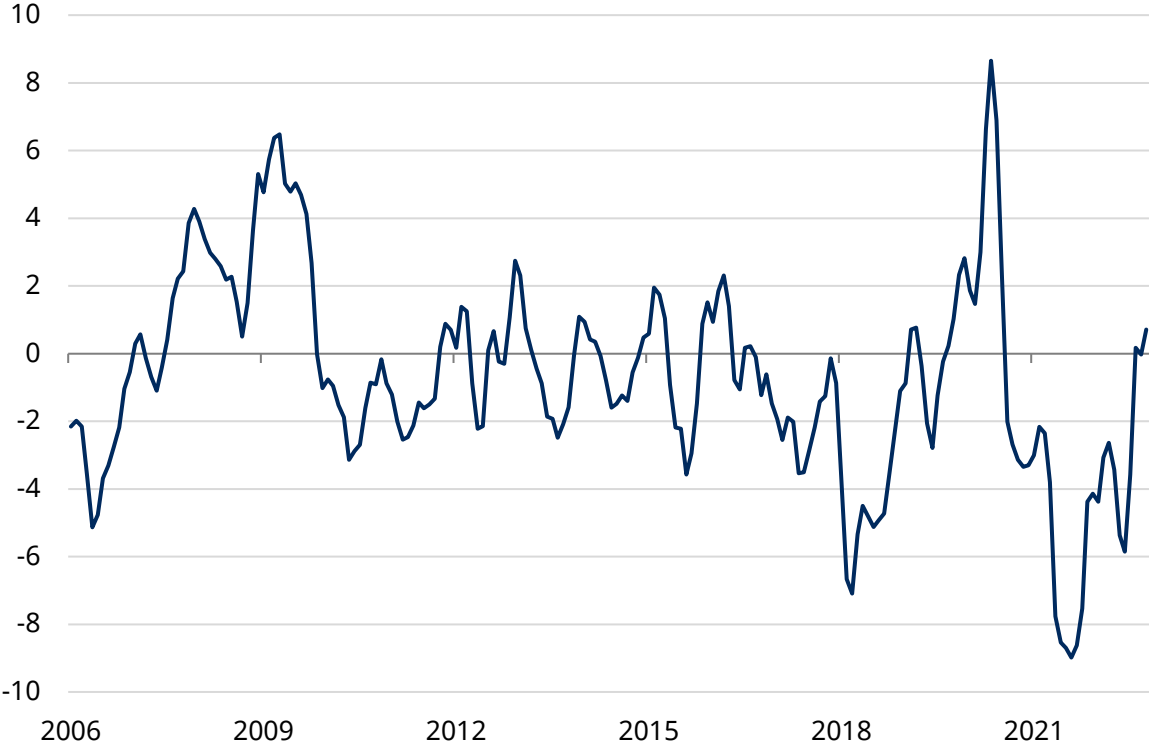
# EM earnings revisions are negative

...but have improved relative to DM

### EM earnings revisions<sup>1</sup> (3-month average)



### EM minus DM earnings revisions

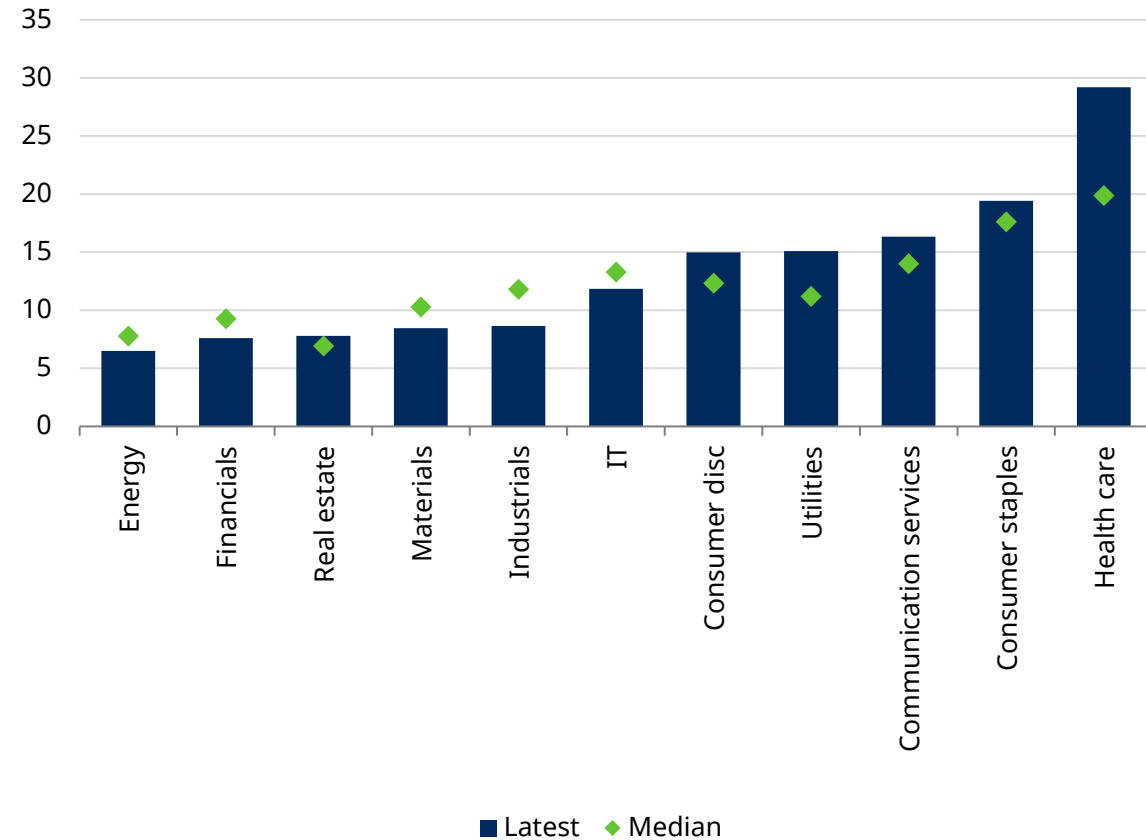


Calculated as the number earnings upgrades minus the number of earnings downgrades divided by the total numbers of earnings updates.  
Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Variability in sector valuations remains high

Higher P/E sectors are still expensive versus history

## The MSCI EM Index 12-month forward P/E ratios of sectors



## Standard deviation of EM sector forward P/E ratios

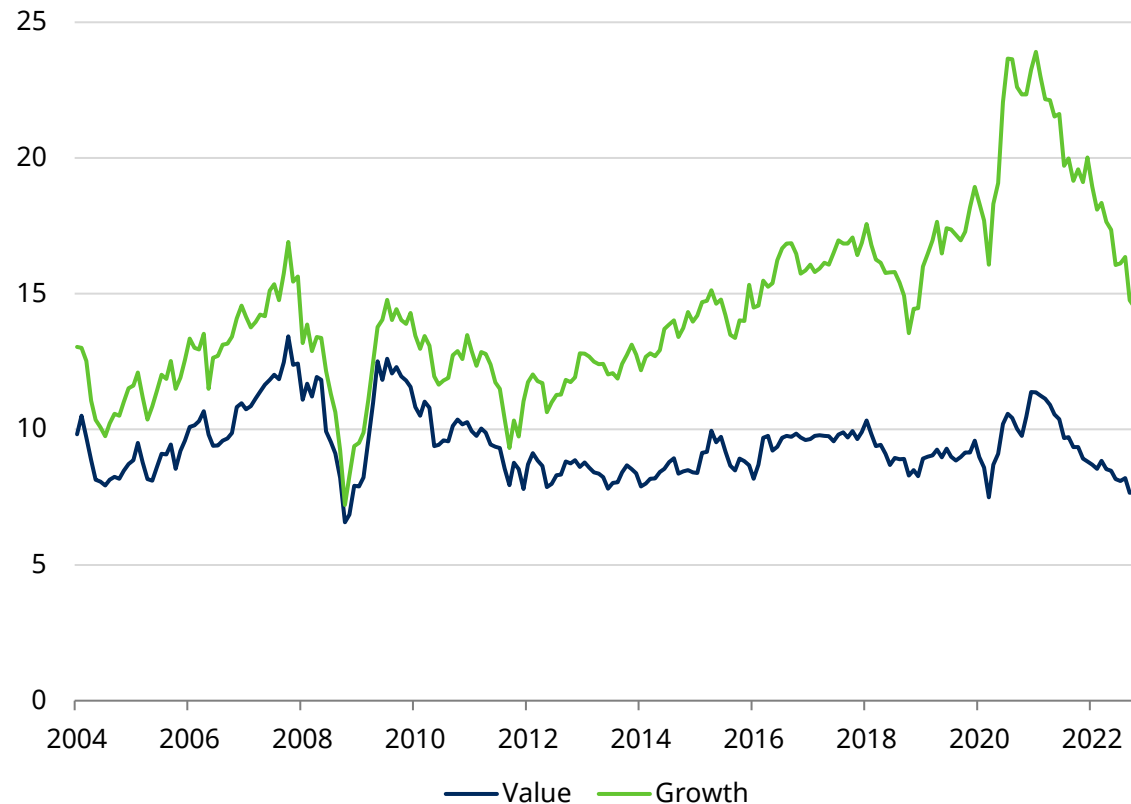


**IT sector has de-rated from 15x at the outset of 2022**

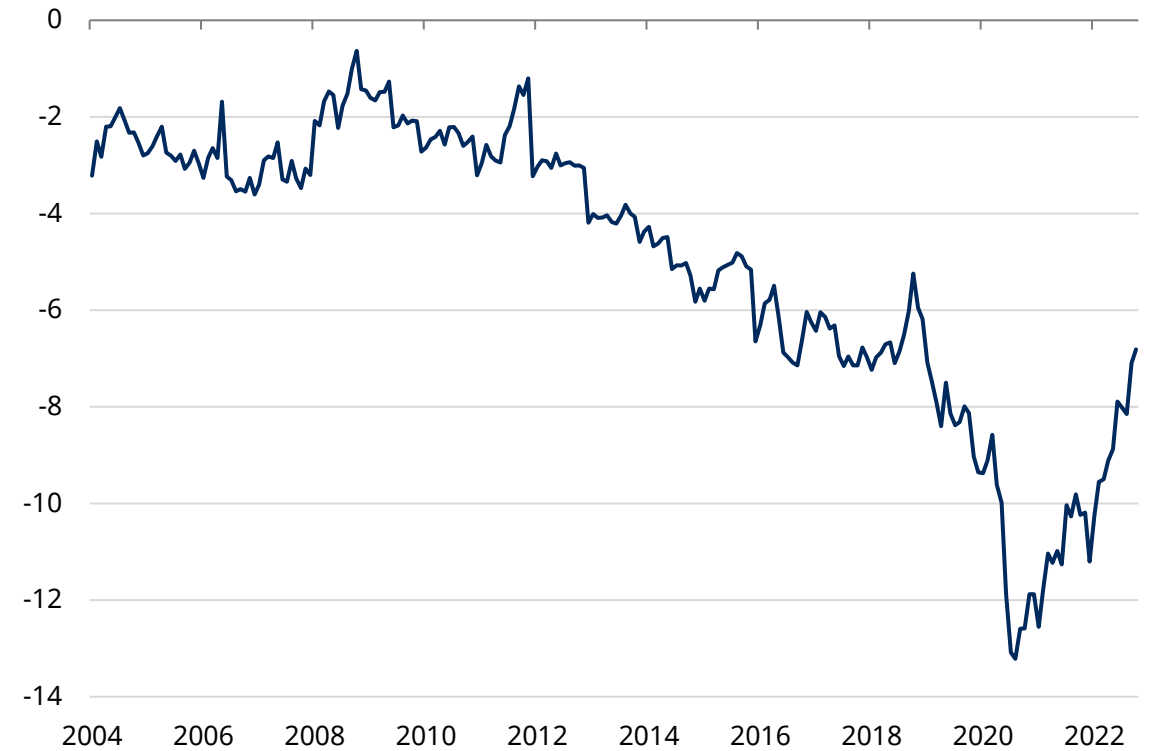
Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022. Median since January 1999.

# Value versus growth in EM

## The MSCI EM Value and Growth 12-month forward P/E



## EM value minus growth 12-month forward P/E



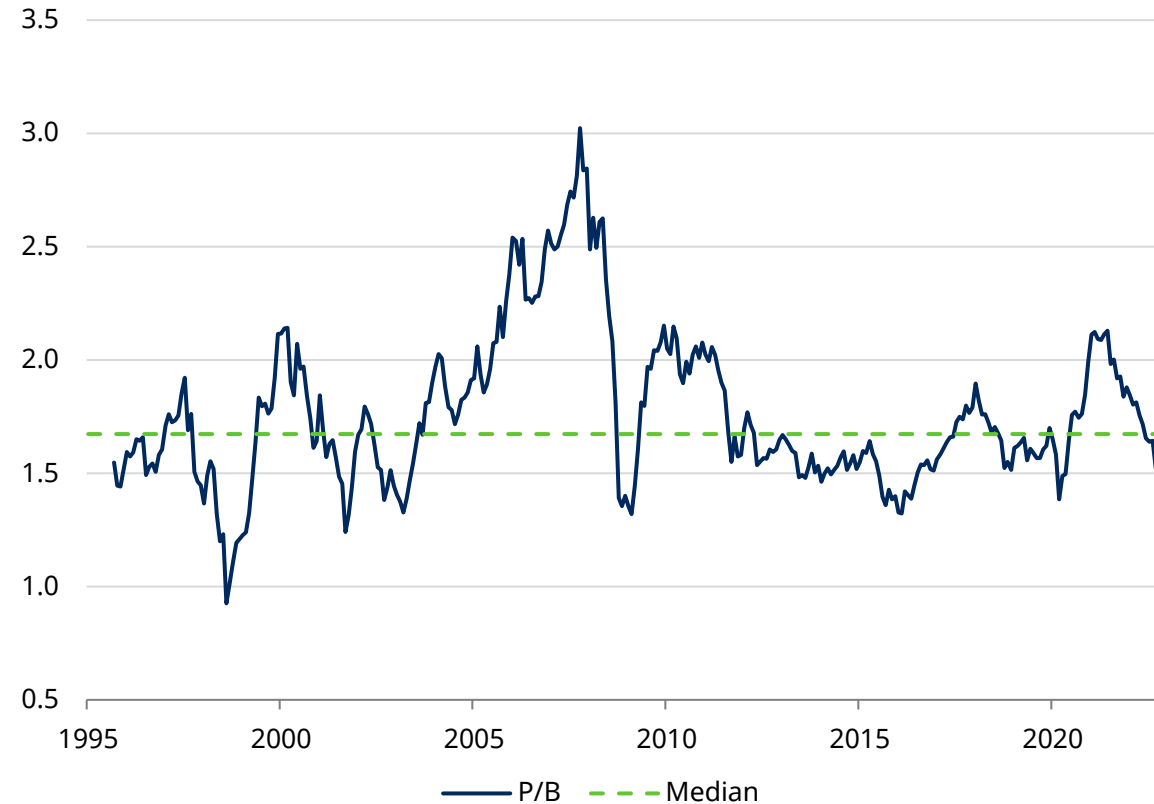
**Value's discount to Growth has been narrowing since 2020**

Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022

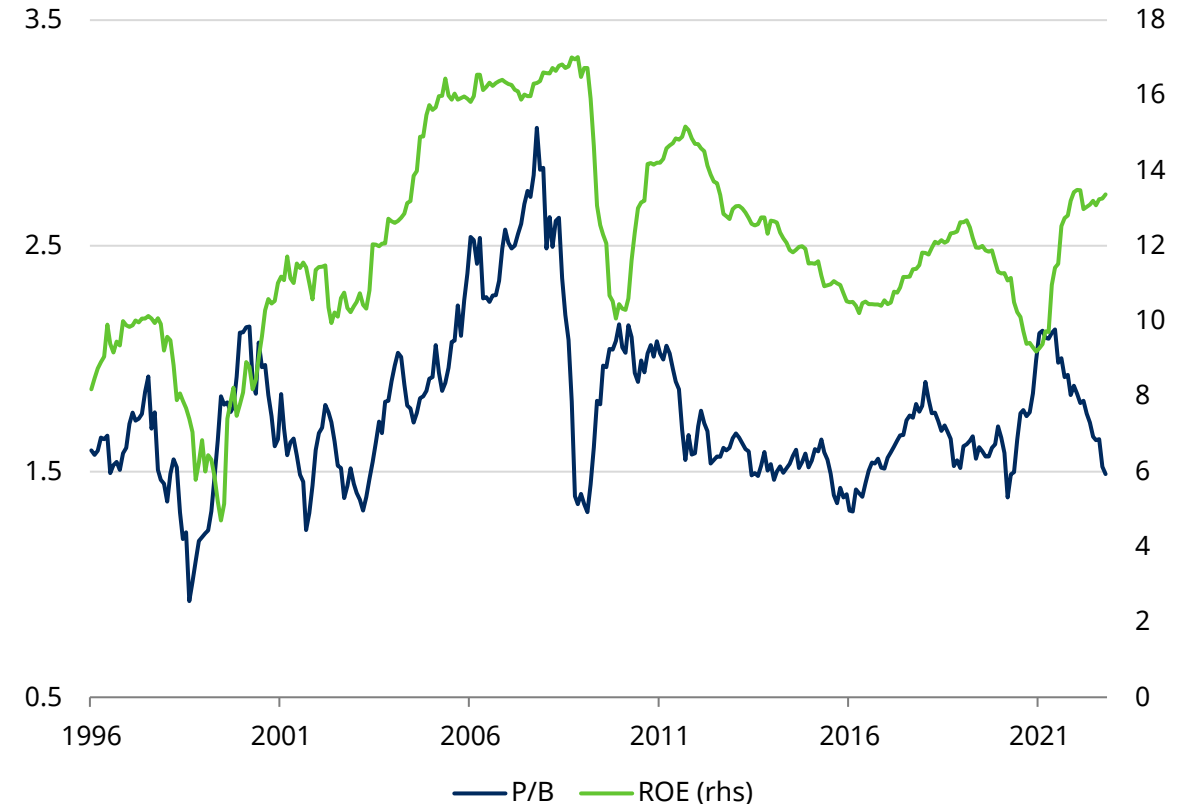
# Other valuation metrics: price-to-book ratio

The P/B ratio has moved below the historical median

## The MSCI EM Index P/B



## The MSCI EM Index P/B and ROE

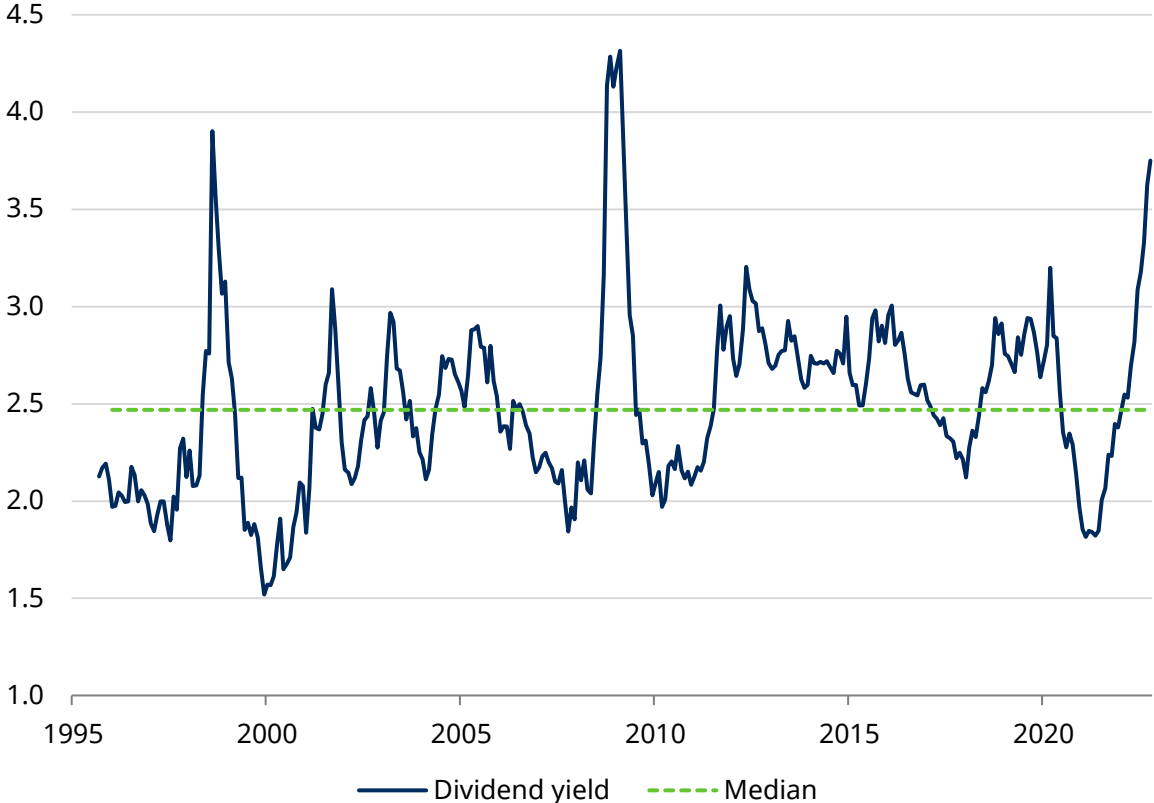


Source: Refinitiv Datastream, Schroders Strategic Research Unit, MSCI. Data as at 31 October 2022.

# Other valuation metrics: the dividend yield

EM dividend yield has risen well above the historical median

The MSCI EM Index dividend yield (%)



The MSCI EM Index dividend per share (rebased to 100)



**EM dividend yield has reached a post-GFC high**

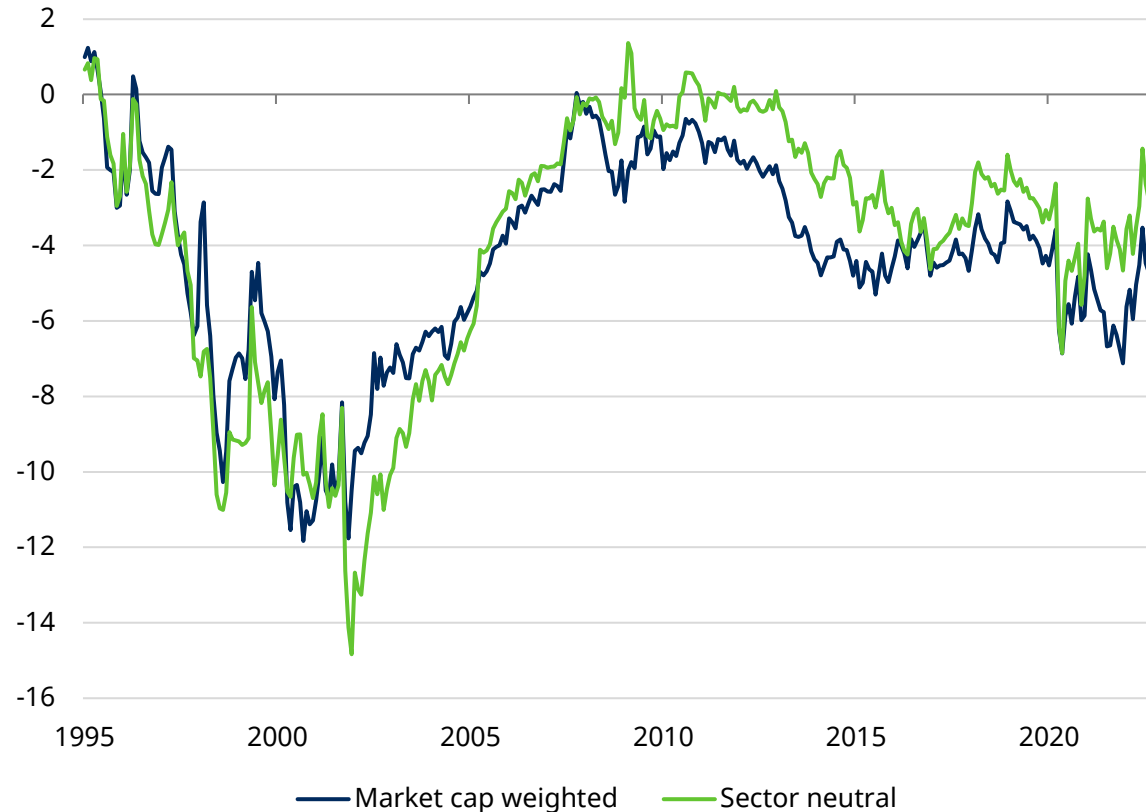
Source: Refinitiv Datastream, Schroders Strategic Research Unit, MSCI. Data as at 31 October 2022.



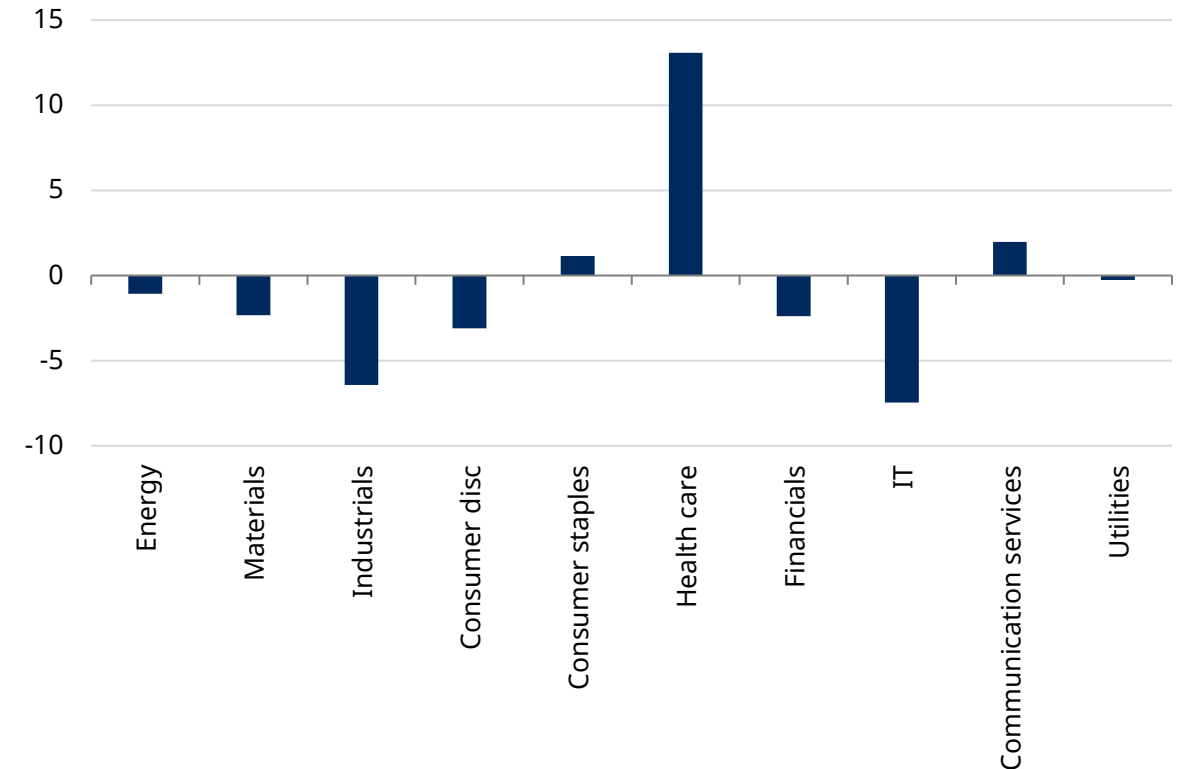
# Emerging versus developed market valuations

EM equities are cheap compared to DM equities but less so on a sector neutral basis

## EM minus DM 12-month forward P/E



## EM minus DM 12-month forward P/Es of sectors



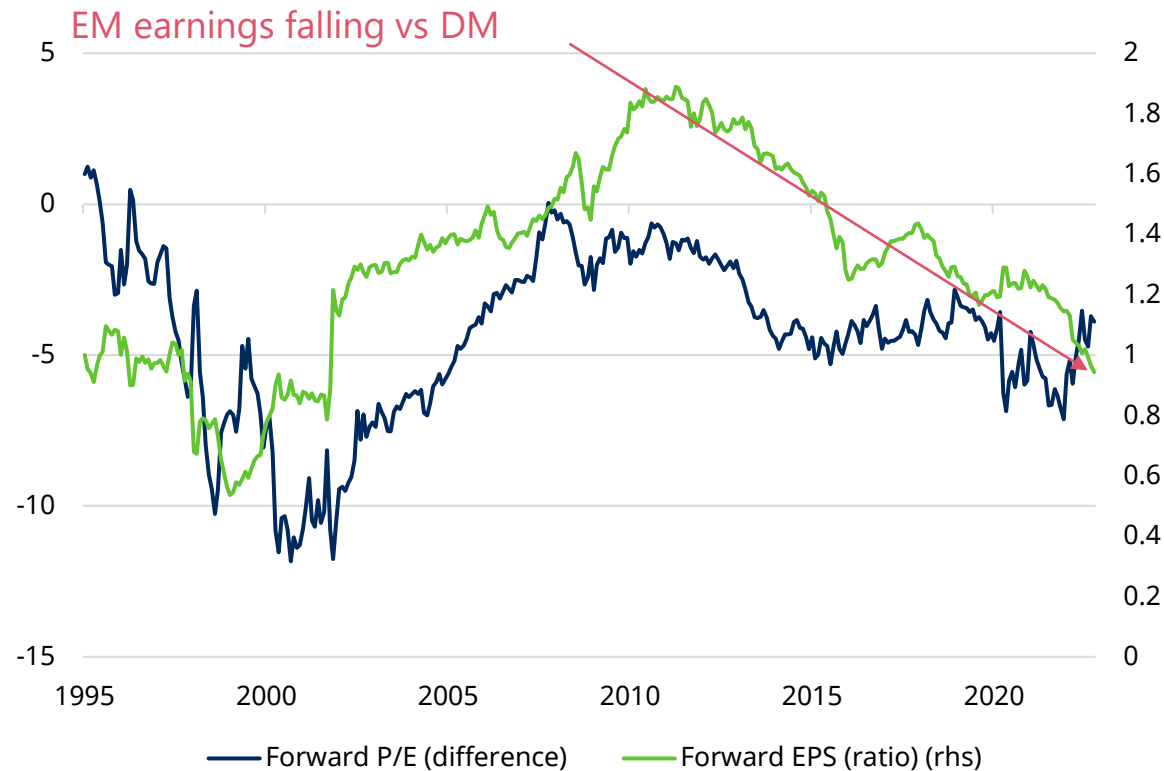
EM sector neutral valuation gap to DM has narrowed this year

Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

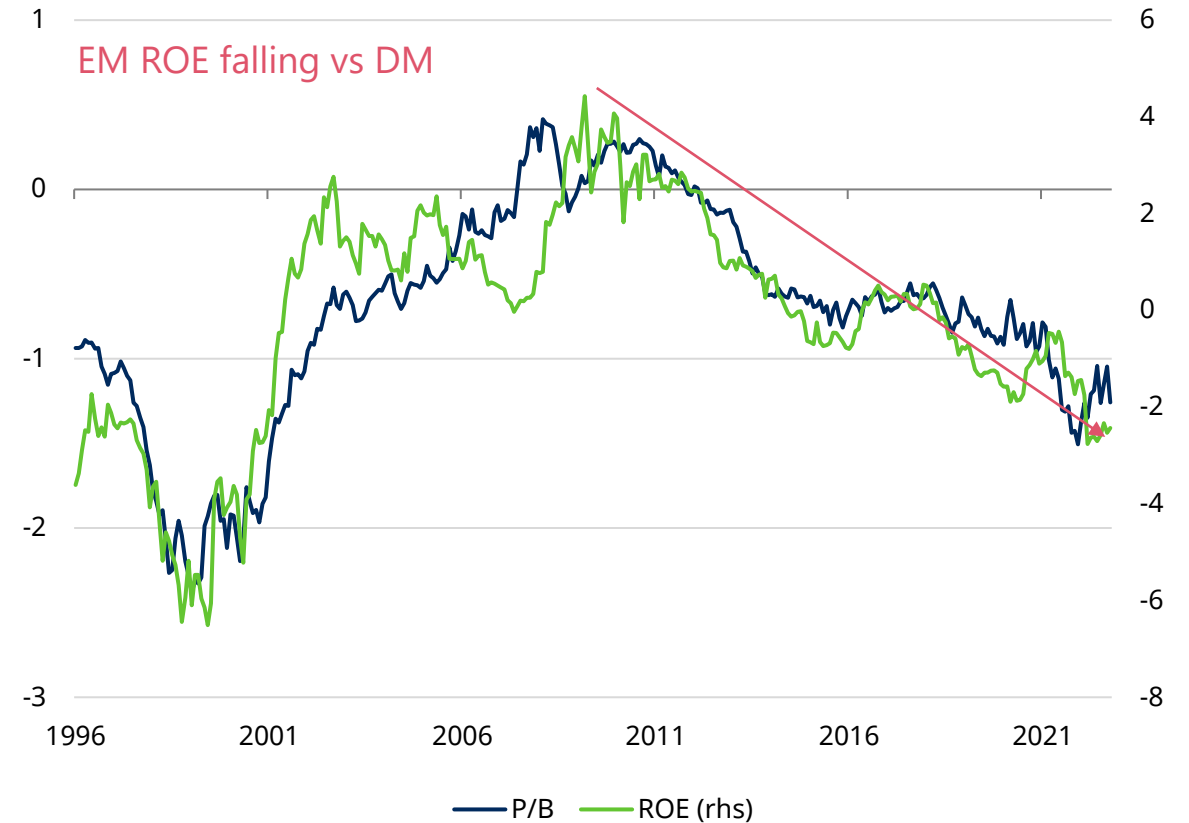
# Drivers of EM/DM valuation gap

Better earnings and profitability needed to reduce EM discount to DM

## EM minus DM 12-month forward P/E and EPS



## EM minus DM P/B and ROE



Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Emerging markets index composition

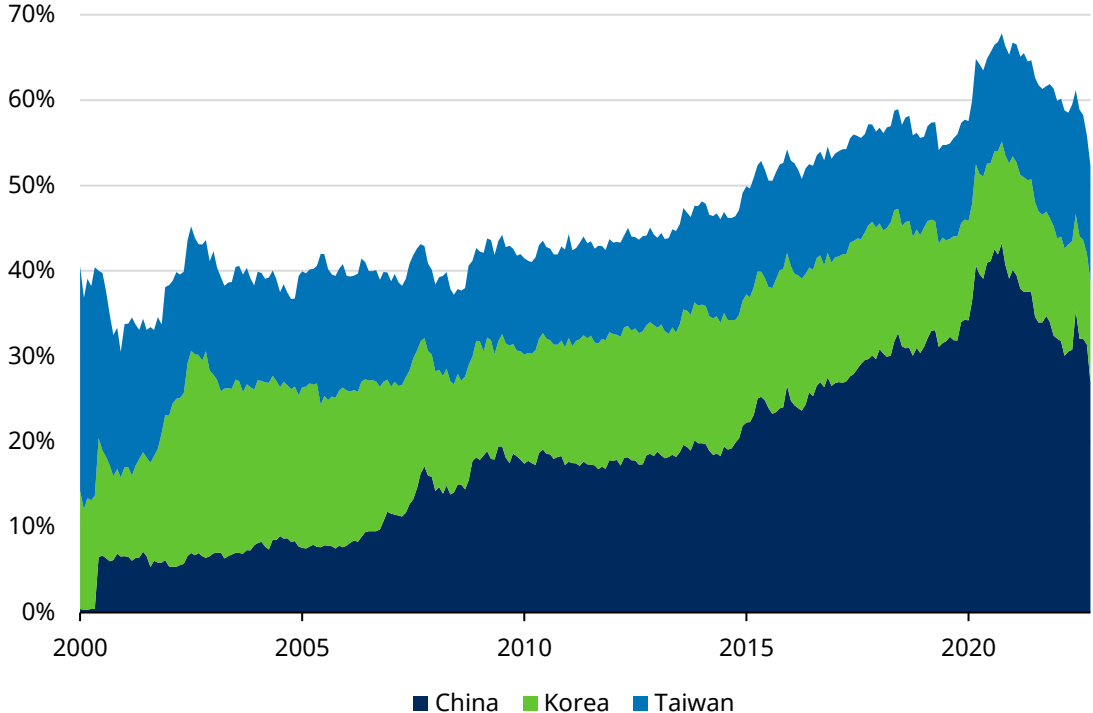
EM is dominated by Asia

The MSCI EM Index share of regions



■ Asia ■ EMEA ■ Latam

China, Korea and Taiwan are just under 60% of the EM index

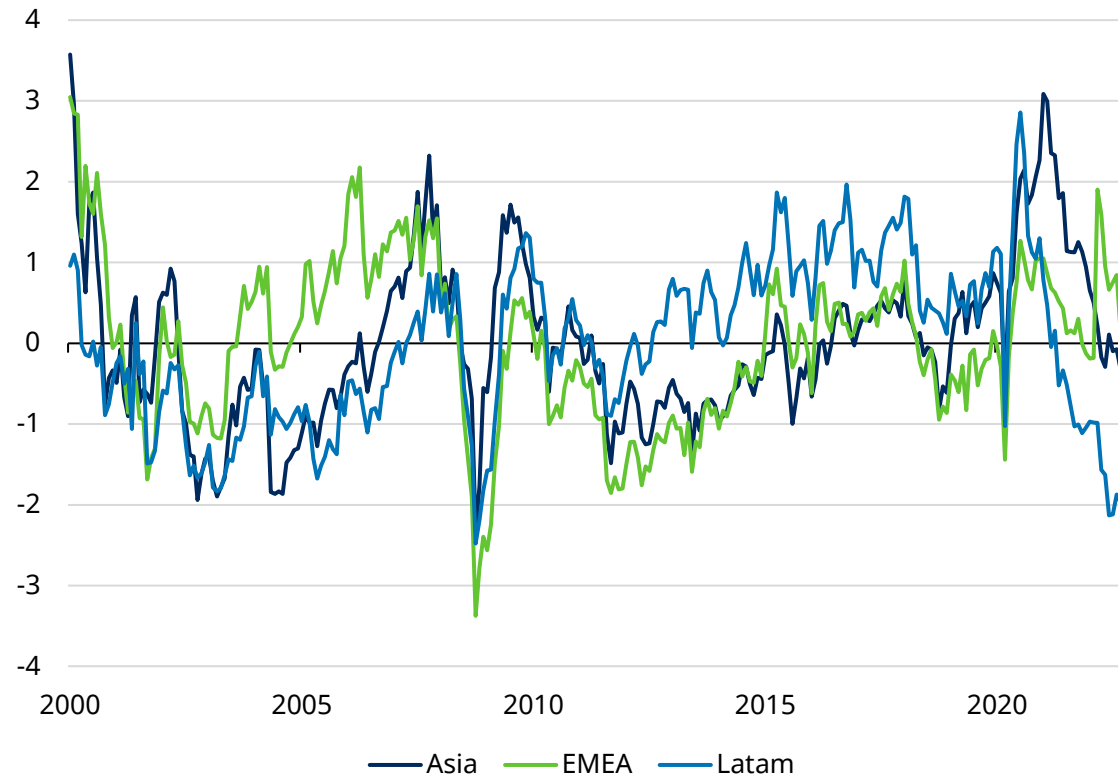


Three large North-east Asia markets have a big impact on aggregate EM valuations

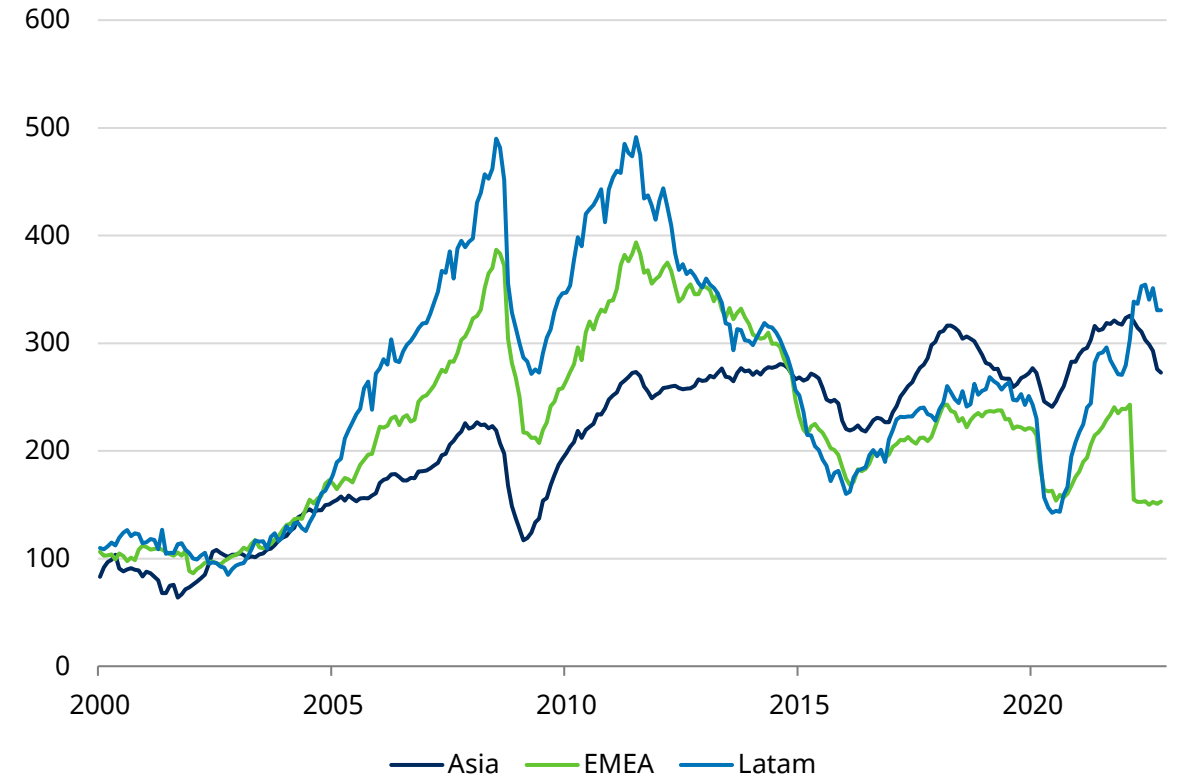
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Valuations and earnings expectations in EM regions

## Standardised 12-month forward P/E (z-score<sup>1</sup>)



## 12-month forward EPS of EM regions



**Latin America remains the cheapest region. Valuations in Asia are now slightly cheap. EMEA valuations spiked because of the exclusion of the very cheap Russian market.**

Source: Refinitiv Datastream, Schroders Strategic Research Unit, MSCI. Data as at 31 October 2022. <sup>1</sup>The z-score is a measure of how far valuations are from historical mean.

# Regional valuation gap is affected by sector exposure

Asia is dominated by growth sectors; EMEA and Latin America by value sectors

### The MSCI Emerging Markets Index



### The MSCI EM Asia Index



### The MSCI EM EMEA Index



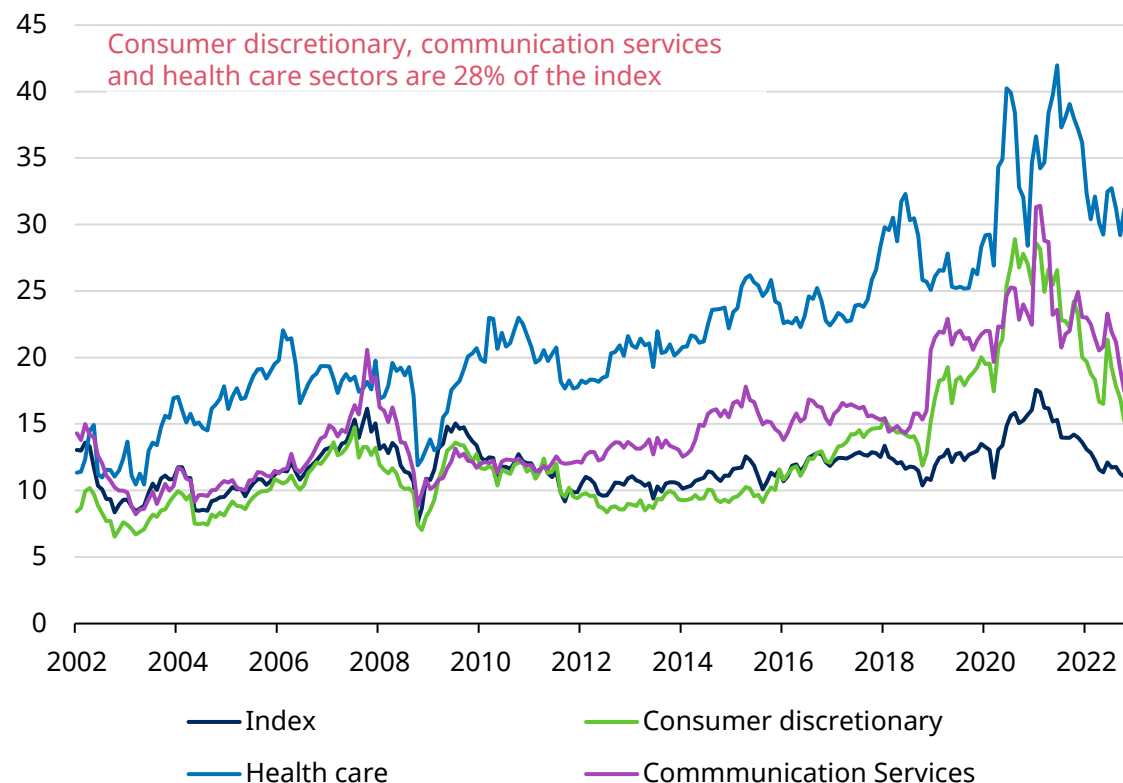
### The MSCI EM Latin America Index



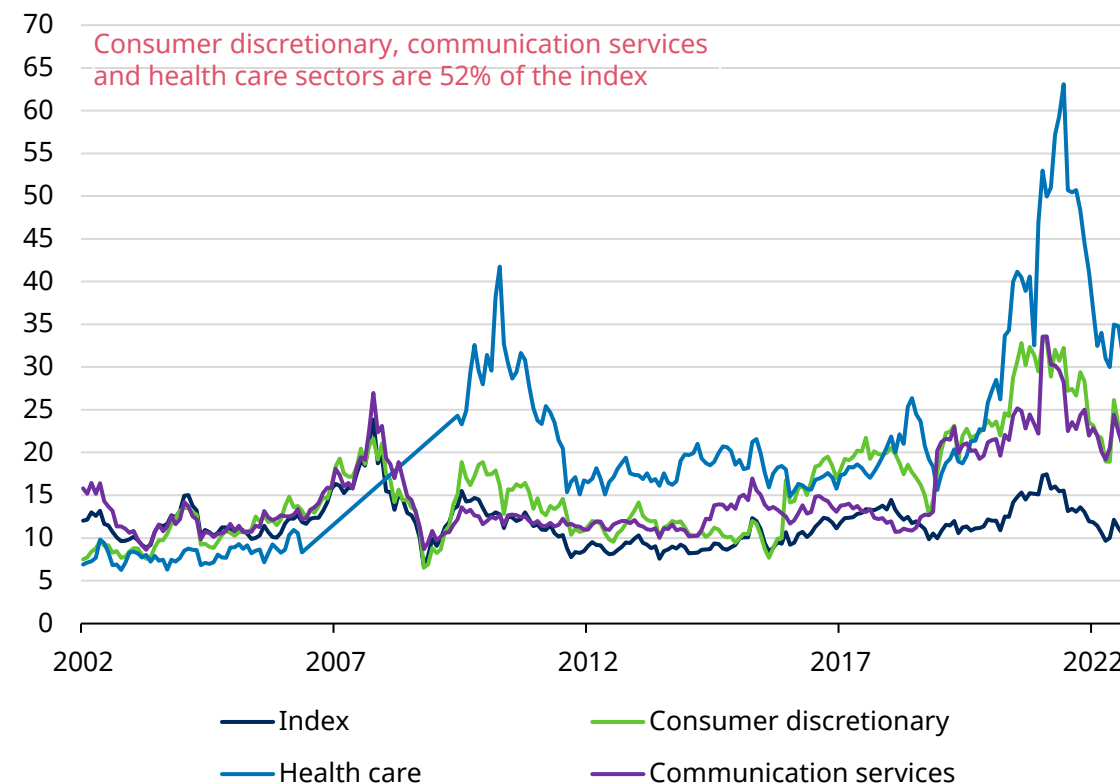
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit, Data as at 31 October 2022. **Value sectors:** energy, materials, industrials, financials, utilities, real estate. **Growth sectors:** consumer discretionary, consumer staples, health care, IT, communication services.

# EM Asia forward P/E has been highly influenced by few high-flying sectors

## The MSCI EM Asia Index sector forward P/E ratios



## The MSCI China Index sector forward P/E ratios

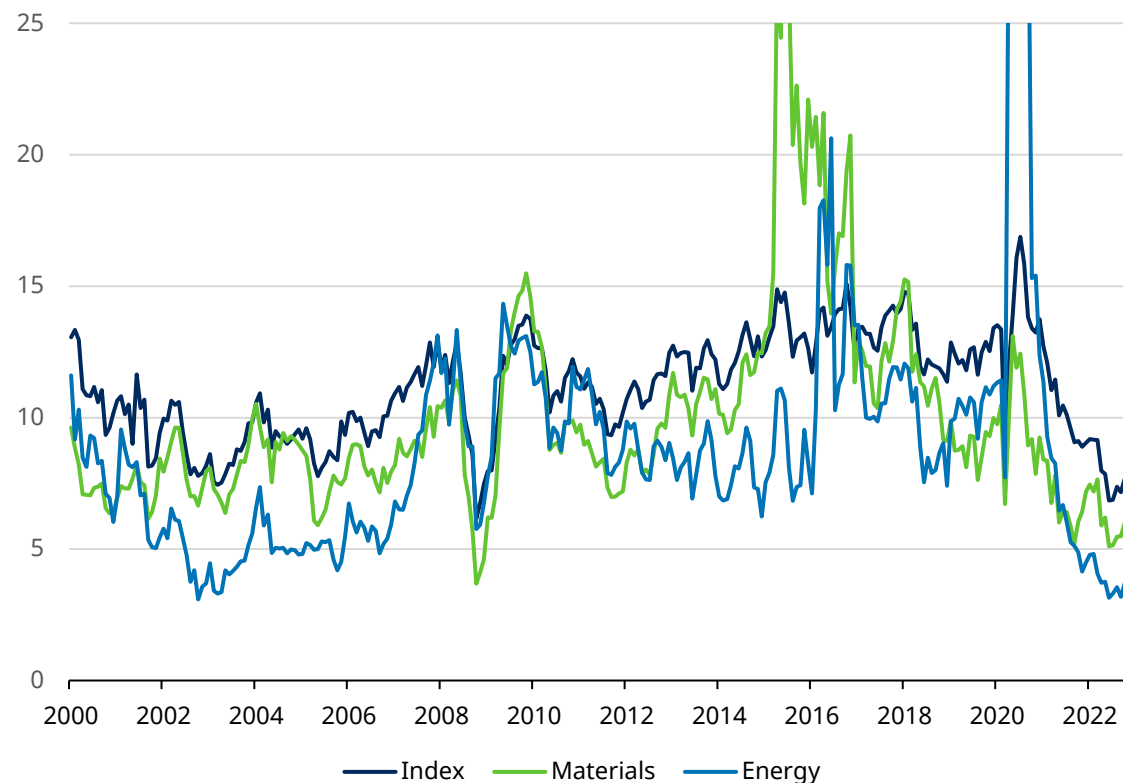


The YTD correction in high P/E sectors has pushed valuations lower in China + broader EM Asia

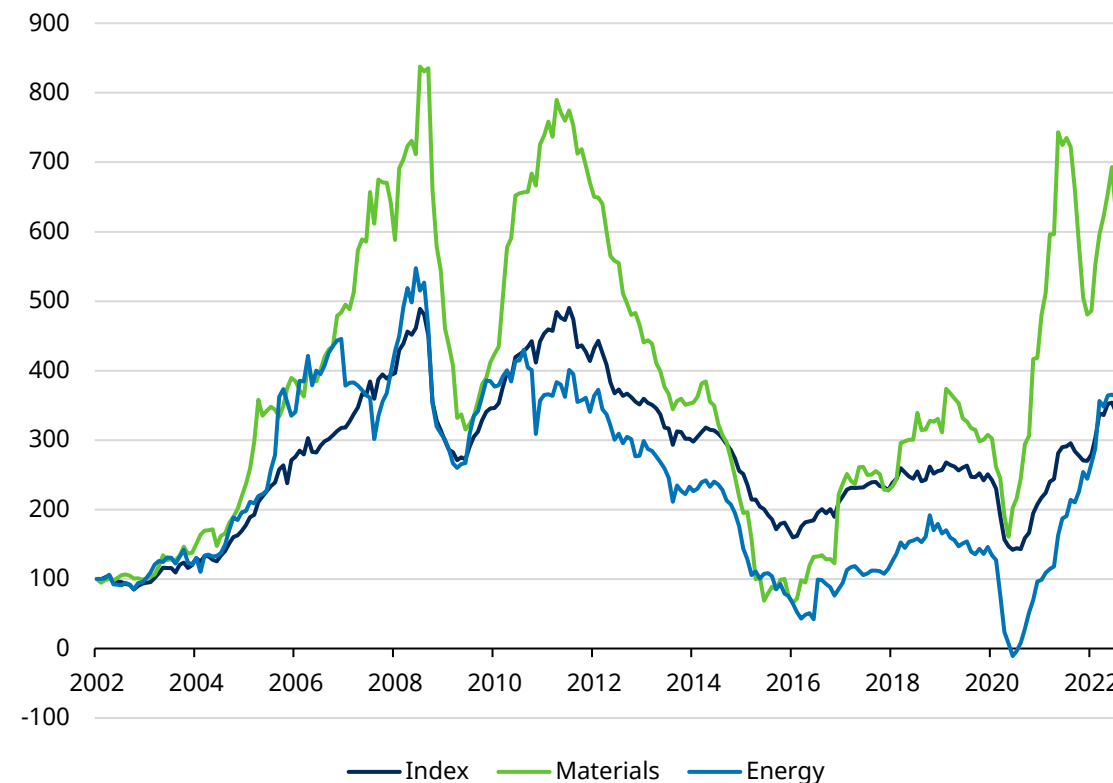
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Valuations in Latin America have been highly influenced by commodity prices

## The MSCI EM Latin America Index forward P/E ratios



## The MSCI EM Latin America Index forward EPS



## Earnings expectations in the Latin American materials sector are falling

Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# EM country-level valuations

## How countries stack up when measured against their own history

On a combined valuation basis, all EM markets ex. India, Thailand, and Indonesia are cheap vs history.

### **Asian market valuations are mixed :**

- India is still the most expensive market in the EM index. ([Read more](#))
- China is now cheap versus history. ([Read more](#))
- Malaysia is the cheapest market in Asia.

### **The Latin American markets offer the most compelling valuations:**

- Chile and Brazil are the cheapest markets in EM, when measured against their own history.
- Mexico, Colombia and Peru are also undervalued relative to their own history.

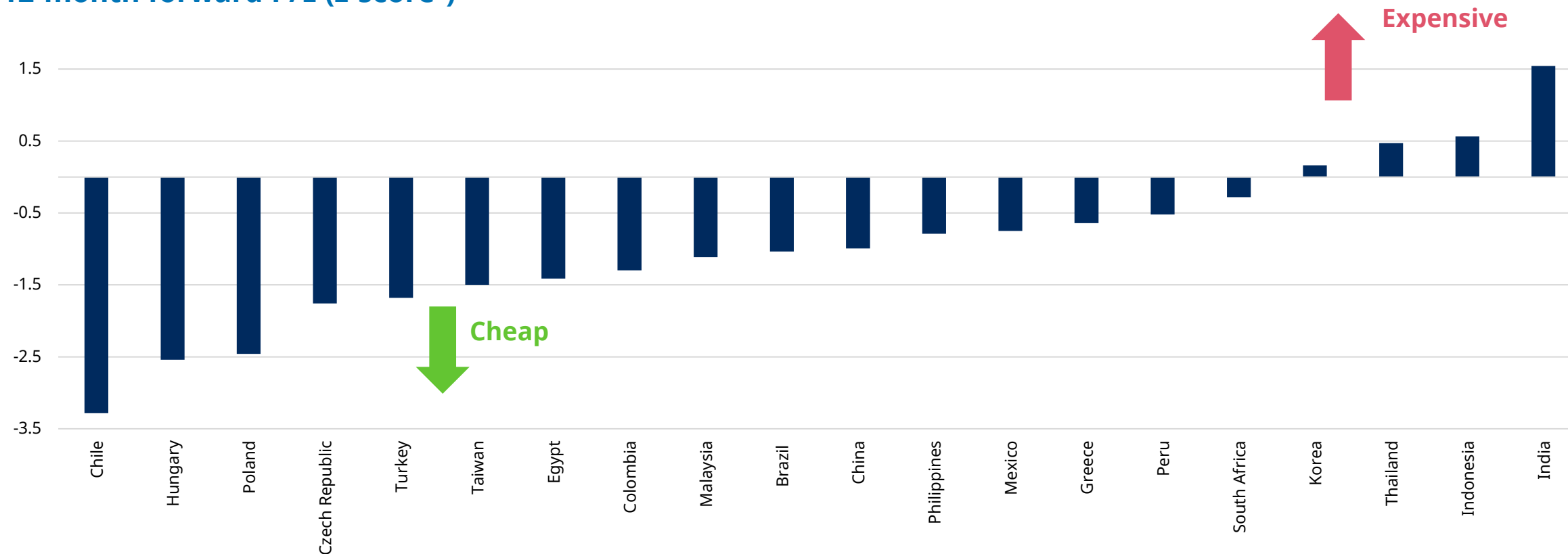
### **The EMEA markets, ex-South Africa, are all cheap:**

- Poland and Hungary are the least valued in the region.
- Valuations in Greece and Czech Republic are the least appealing in EMEA, but still below the historical average.



# Standardised EM country valuations: the forward P/E

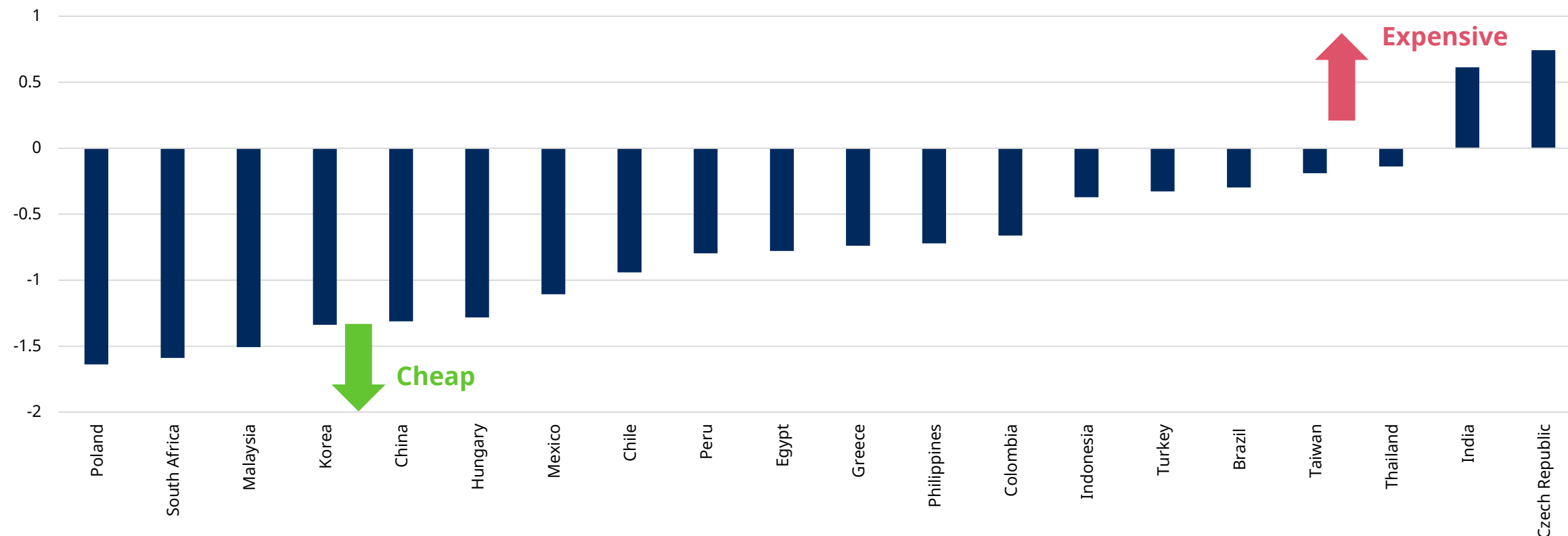
## 12-month forward P/E (z-score<sup>1</sup>)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. <sup>1</sup>The z-score is a measure of how far valuations are from historical mean, calculated since January 2000. Source: Schroders, Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Standardised EM country valuations: the P/B ratio

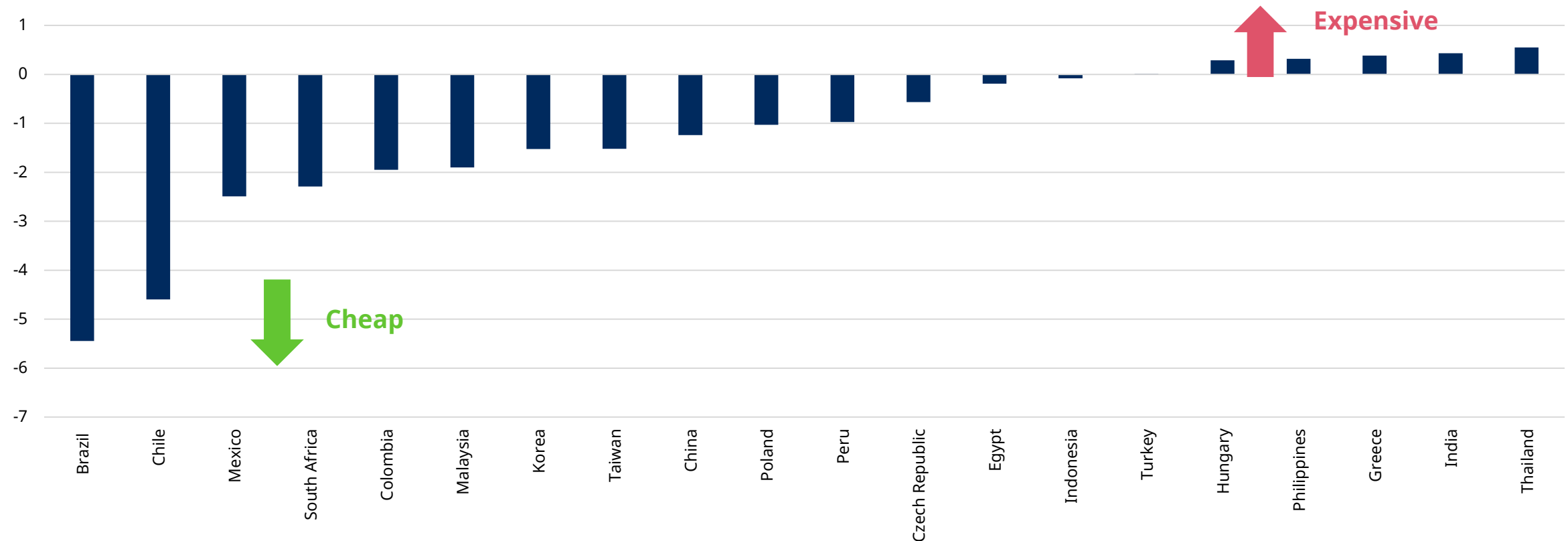
## The P/B ratio (z-score <sup>1</sup>)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. <sup>1</sup>The z-score is a measure of how far valuations are from historical mean, calculated since January 2000. Source: Schroders, Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Standardised EM country valuations: the dividend yield

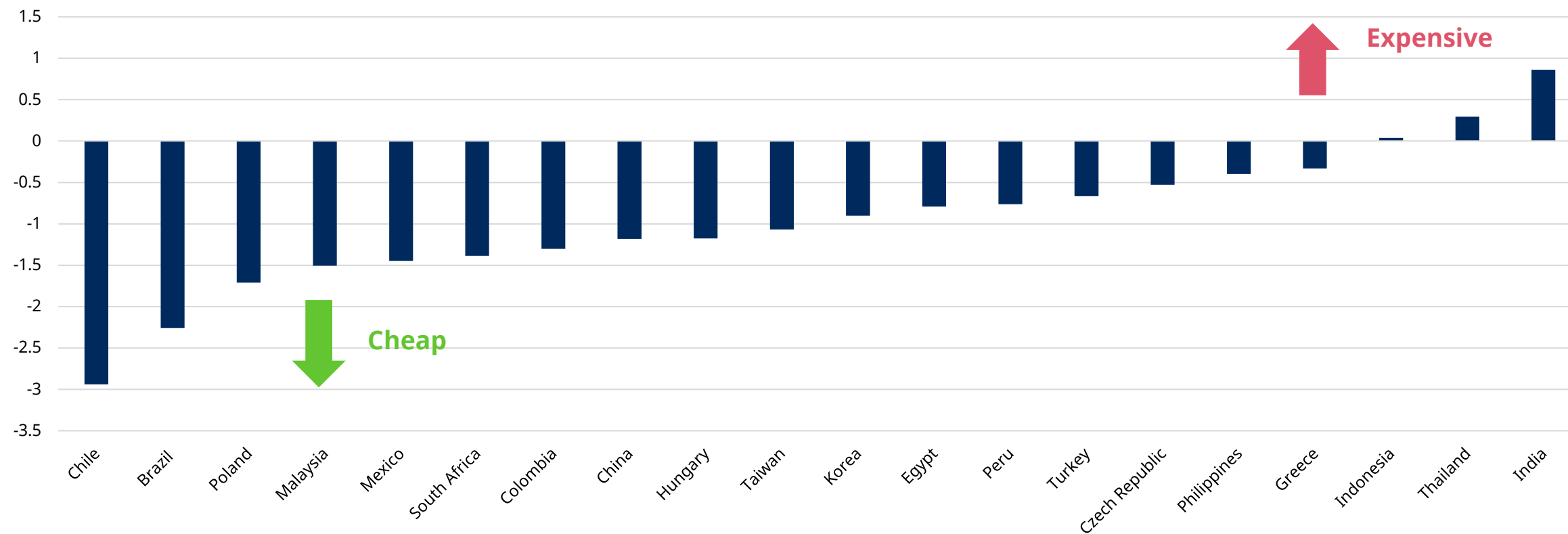
## The dividend yield (z-score <sup>1</sup>)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. <sup>1</sup>The z-score is a measure of how far valuations are from historical mean, calculated since January 2000. Source: Schroders, Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# Standardised EM country valuations: combined

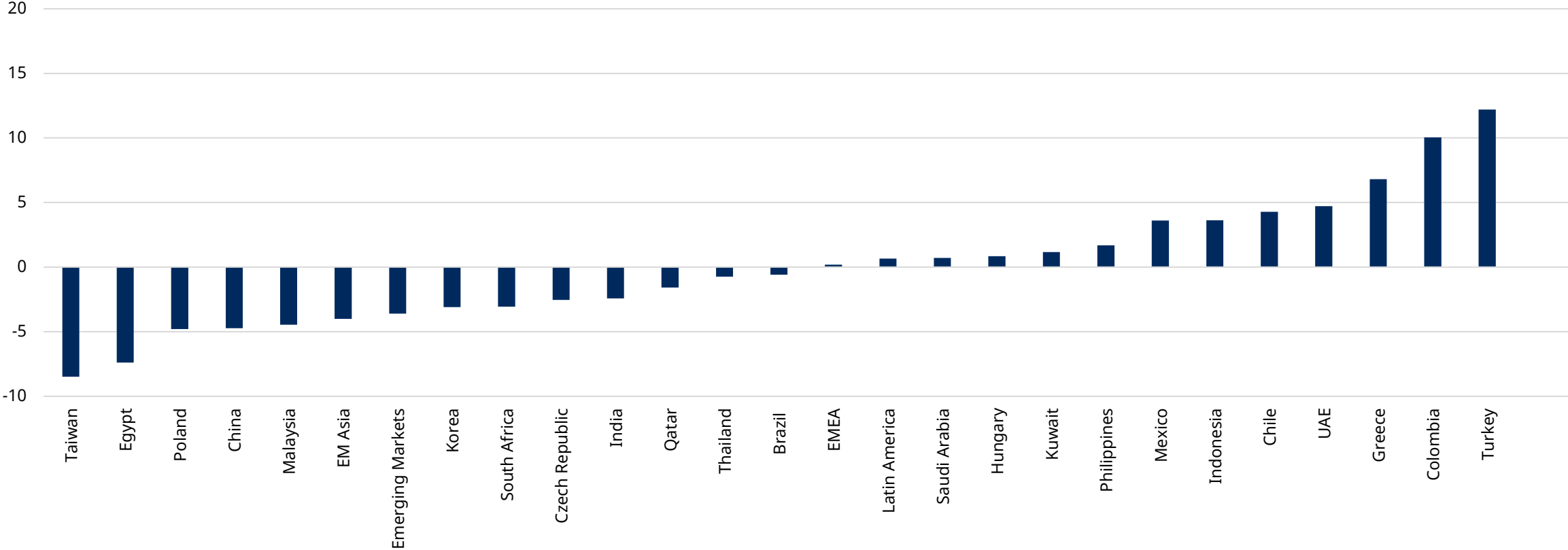
Average (P/E, P/B, dividend yield) (z-score <sup>1</sup>)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. <sup>1</sup>The z-score is a measure of how far valuations are from historical mean, calculated since January 2000. Source: Schroders, Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# EM earnings revisions

Earnings revisions<sup>1</sup> (%) (3-month average)

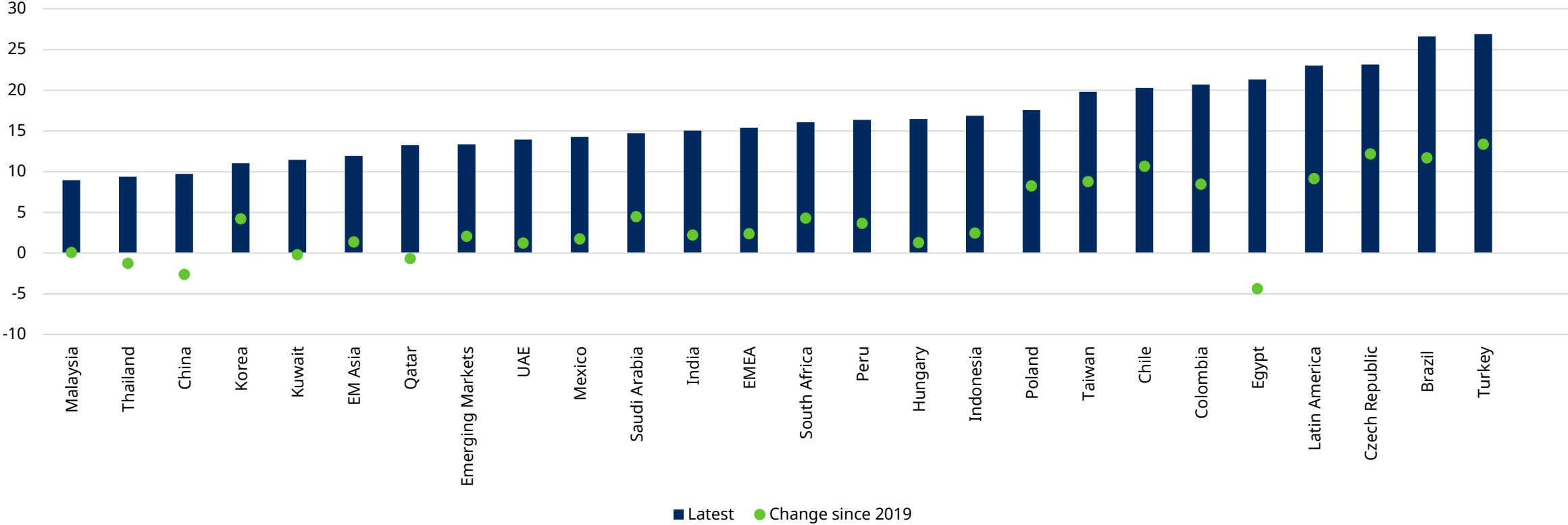


<sup>1</sup>Calculated as the number earnings upgrades minus the number of earnings downgrades divided by the total numbers of earnings updates. Source: Refinitiv Datastream, IBES, Schroders Strategic Research Unit. Data as at 31 October 2022.

# EM return on equity

Profitability is improving in a majority of EM markets

## Return on equity (%)



Source: Schroders, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.



## EM currency valuations

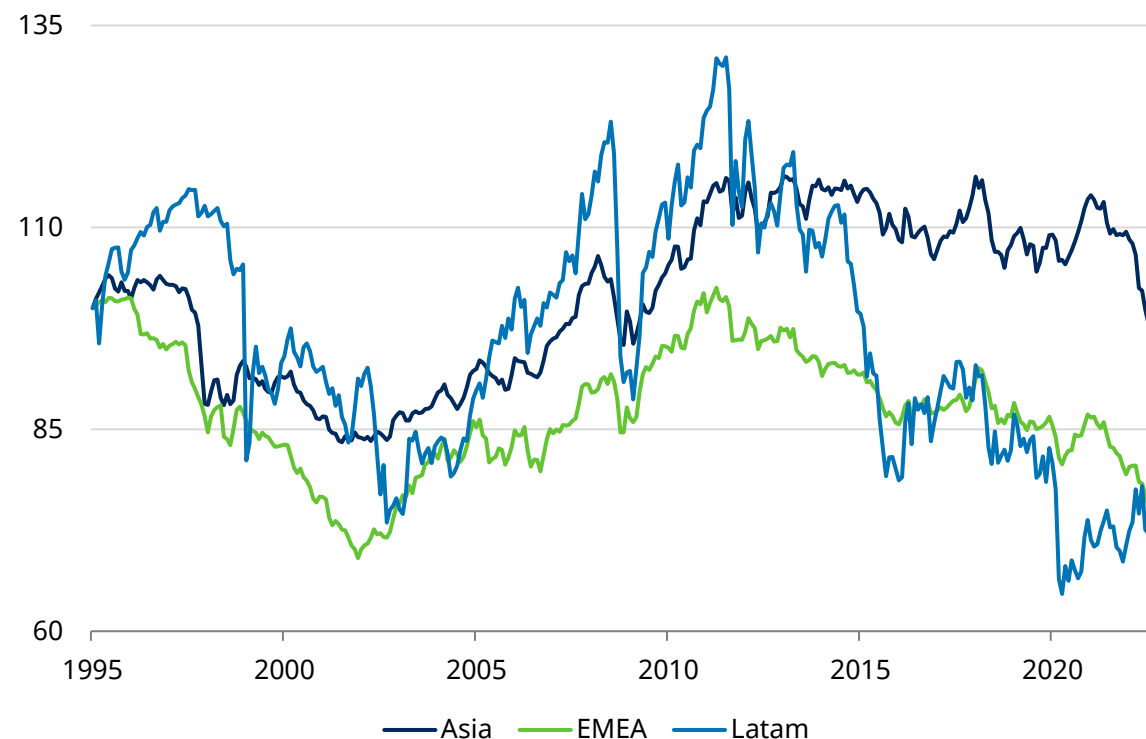
# Is there value in EM currencies?

EM currencies have depreciated in real terms since 2011

## EM real exchange rate<sup>1</sup>



## EM real exchange rates of regions<sup>1</sup>



**There are significant differences between regions; Latin America and EMEA currencies are cheapest**

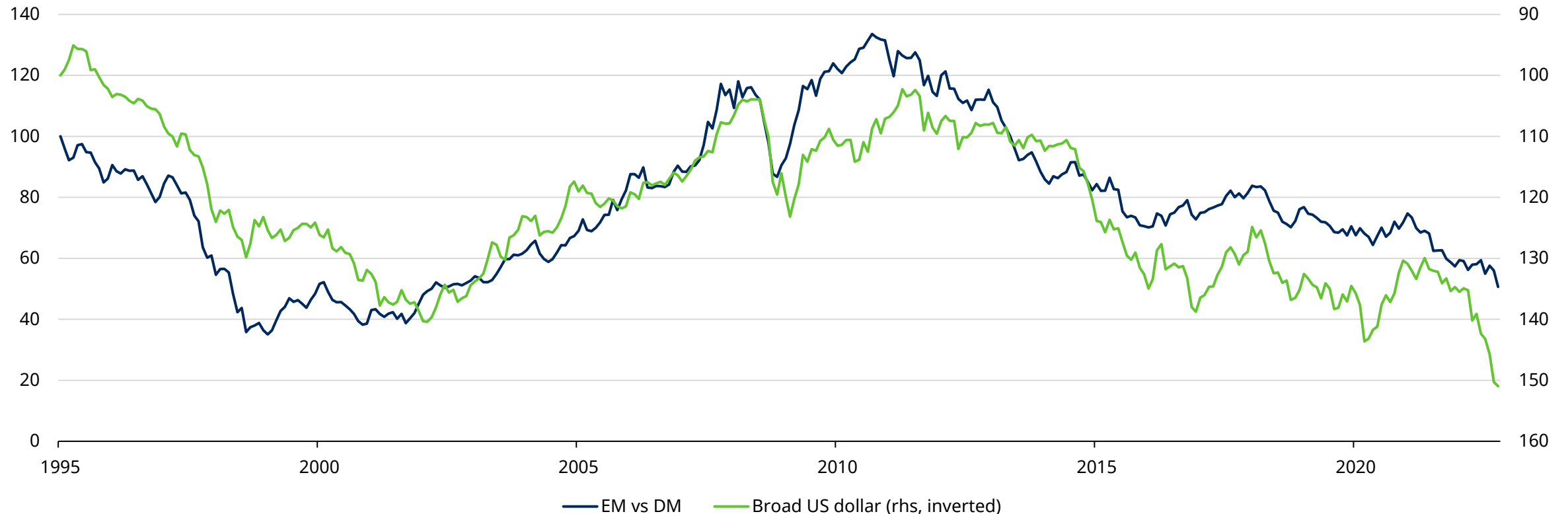
Real exchange rate is the nominal dollar exchange rate deflated by the CPI of each EM country vs. US. <sup>1</sup>Based on the latest MSCI EM Index country weights.  
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.



# The importance of the US dollar for EM equity performance

The long period of dollar strength has weighed on EM

## EM vs DM equities (total return, rebased to 100) vs broad US dollar

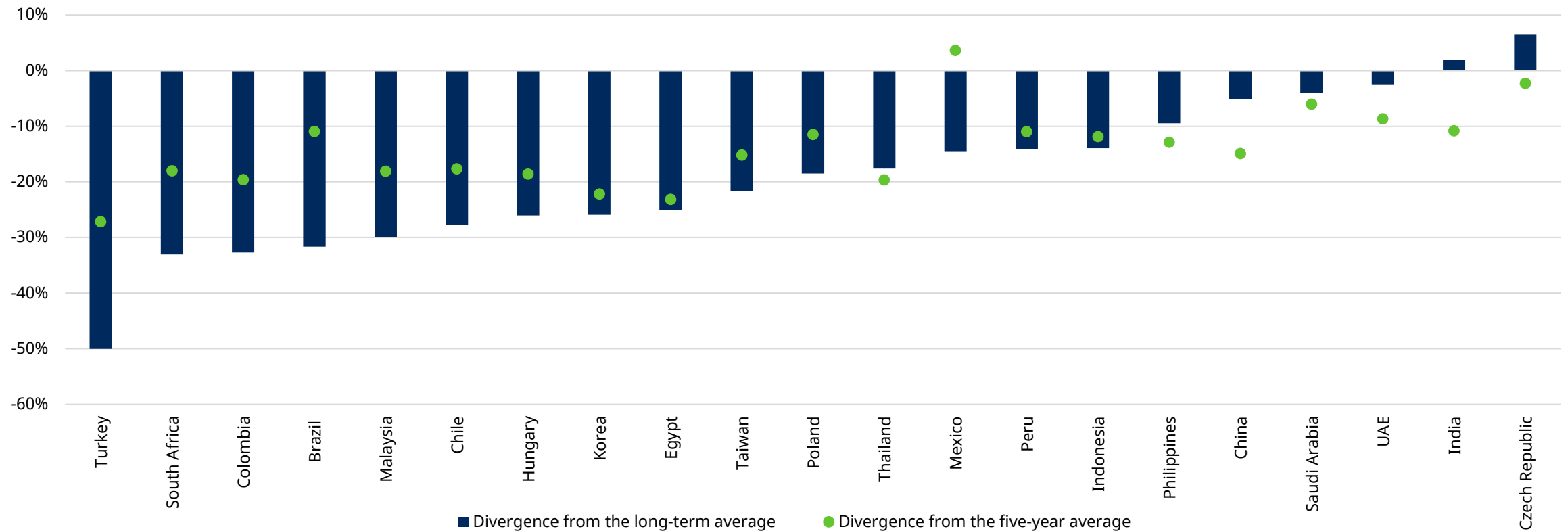


**Past performance is not a guide to future performance and may not be repeated.**  
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 October 2022.

# The value in EM currencies varies considerably

Some currencies are significantly undervalued

Real exchange rate: deviation from average



Turkey, South Africa, and Colombia have the cheapest currencies; Czech Republic and India have a real exchange rate above the long-term average

Real exchange rate is the nominal dollar exchange rate deflated by the CPI of each EM country vs. US Long-term average is since January 1995.  
Source: Schroders, Refinitiv Datastream, Schroders Strategic Research Unit. Data as at 31 October 2022.

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