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**“Synchronized falls in developed and emerging markets due to outdated views on risk”**

**“Emerging markets are currently trading at around half their historical highs ... Based on this valuation and powerful fundamentals, we see the region in an extremely robust position”**

While emerging markets offer superior fundamentals and demographics to their developed peers, both blocks have seen equities drop around 11% over the year so far. On the developed side, ongoing debt issues and other macroeconomic factors explain this stock market malaise, but with a much healthier picture in the emerging world such a decline looks unwarranted.

Charlemagne Capital's Julian Mayo believes this synchronised fall is largely down to outdated views about the risks involved in emerging market investment. Many commentators now see these markets as increasingly attractive on a risk-reward basis, with growth rates materially better than the developed world. Increasing inflows are also expected into the region, lowering the cost of capital and reducing the risk profile further.

Emerging markets have been forced over the past 10 to 15 years into a very conservative balance sheet position, ironically, by developed markets. Yet now it is the developed world facing the problems, leaving investment opportunities in emerging countries. Debt remains a key issue and composite levels – in terms of personal, corporate and government – are generally much lower in emerging nations. Mayo compares Europe's five so-called PIIGS (Portugal, Ireland, Italy, Greece and Spain) with five Eastern countries, Russia, Turkey, Poland, the Czech Republic and Hungary, with the latter set carrying much less debt. “Beyond levels of debt, there is also the ability to pay off this borrowing through future economic growth and emerging markets have the advantage here with superior demographics,” says Mayo. This argument sets aging populations in the West against a growing Eastern middle class of working age and mass urbanisation in countries like China.

Emerging countries are also coming from a much lower base, with average per capita income in China of just \$6000 despite annual GDP growth running above 8% for several years. In India, the level is less than half that and with a \$33,000 average in the European Union, emerging markets clearly have considerable catching up to do.

One of the long-standing arguments on emerging markets has been whether they can de-couple from the West, with many previously closely tied to movements in the US for example. Market falls this year might suggest these markets remain very much coupled but Mayo highlights several reasons beyond demographics as evidence this is not the case. “These markets have traditionally suffered from a lack of domestic investors but the onset of several large pension funds in countries like Chile, as well as the Sovereign Wealth Funds, has created far more buyers,” he adds. “Meanwhile, there is also a growing strategic appetite among Western investors for emerging markets, based on the growth potential and obvious advantages over the West.”

Another key factor in decoupling is greater internal trade, with even an export-dependent country like Korea now doing around half of its business with other emerging markets. This is down from 75% exports to developed nations in the recent past and means the country is no longer as tied in to any downturn in the West. Despite overwhelming arguments in favour of emerging markets, perhaps the most interesting opportunity lies in the fact Western equities still trade at a premium. Looking at price/earnings multiples, the emerging region is currently on around 11.5x/12x for this year and 10x/11x for next, looking extremely cheap considering it has traded at 20x over the years. “Emerging markets are currently trading at around half their historical highs in valuation terms and at a discount to their level in 2007 before the downturn began,” adds Mayo. “Based on this valuation and powerful fundamentals, we see the region in an extremely robust position as we potentially head towards a renewed slowdown in global markets.”

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