

Emerging Markets with Richard Titherington

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Is the case for emerging markets still intact?

After emerging markets (EM) rose a stunning 57.5% (in sterling terms) in 2009, some investors may well be wondering if they have reached an unsustainable peak.

Yet in our view, rather than be fearful of such a strong rebound, it is worth remembering that the 2009 rally began from valuation levels similar to crisis lows seen only a handful of times during the past two decades and merely returned to what many would believe to be fair value.

Emerging countries economic growth is enabled by globalisation, significant improvements in economic stability and stronger fiscal discipline – both at the sovereign and corporate level. The resulting current account surpluses and de-levered corporate balance sheets have left emerging markets in a strong position during the current global cycle.

However, the real drivers of domestic growth within emerging markets are industrialisation, infrastructure development and urbanisation. These trends create a wealth of opportunities for equity investors within these markets. Whether it's mortgage lenders in Mexico, mobile telephone operators in South Africa or beverage distributors in China, these trends are creating new opportunities to serve a growing domestic consumption base every day.

Equally, significant infrastructure investment – roads, railways, homes – is necessary to support the growth within these markets, which means opportunities for iron ore producers, local cement manufacturers, and home builders.

How company profits can sustain growth

Of course, this significant investment means benefits for companies. We expect earnings growth to be the primary driver of returns during 2010 and beyond, reflecting not only healthy economic growth but also improved corporate capital discipline.

Economies recovering from recessions or slowdowns provide a positive tailwind for company profit growth generally. After profit expectations jumped off a cliff 18 months ago, they have come back over the last six to seven months.

We believe there are three main catalysts that should help this profits recovery continue:

- when companies bounce back to normal levels
- where economic growth and a trend towards better disciplined companies fuels company profit growth
- where reasonably good local company profit growth exists, but currency revaluation benefits could make these profits much stronger in US dollar terms

To conclude, with EM stocks on attractive valuations it is a reasonable assumption that strong profits growth should help support further share price gains.

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