iShares by BLACKROCK

Value Emerging

In the past year equities markets around the world have continued to rally. Panic over the state of the European Union has slowly subsided and the US economy continues to grind its way out of the GFC-led mire.

Increased optimism among investors has driven valuations in many developed markets to multi-year highs. For example, the one year forward Price to Earnings (PE) ratio on the S&P500 is around 15.6 times – its highest in close to four years.

Similarly, the one-year forward PE on the Euro Stoxx 50 index recently reached around 13 times. This is up from a low of around eight times in late 2010, and the highest level since the end of 2009.

In contrast to the bullish price action in developed markets, emerging market equities indices have fallen from recent highs as money has flowed back into the developed markets. The chart below compares the one-year forward PE of world developed markets (represented by the MSCI World index) with that of emerging markets (represented by the MSCI Emerging Markets index).

Divergence emerging as valuation differentials between EM and DM widen

Price / Earnings

In June this year a wobble in the MSCI Emerging Markets index occurred after US Federal Reserve chairman Ben Bernanke indicated that tapering of the quantatative easing (QE) program that has been in place for several years could begin sooner rather than later. This talk of less-loose monetary policy in the US caused a minor panic and a rush for the exits from investors in emerging markets stocks. Of particular concern was what the scaling back of QE might mean for those EM markets with large current account deficits. Those countries were thought to be especially vulnerable given that QE had had made it easier for emerging economies to finance current account deficits, and that a reduction in loose US monetary policy could cause an issue for developing nations reliant on overseas lenders.

With no Taper announced at the Fed's September meeting recently, the short term worry may have subsided. In the longer term, now might be a good time to take a closer look at allocations to emerging markets.

Taking a closer look

In his recent Market Perspective, BlackRock's Chief Investment Strategist Russ Koesterich opined that "*[t]o the extent many are underweight or not exposed to [the emerging markets] asset class, valuations suggest a good long term entry point*". See http://us.ishares.com/content/stream.jsp?url=/content/en_us/repository/resource/market_perspectives_october_2013.pdf Given the recent sell off and attractive valuations, we think this makes sense from a long-term view.

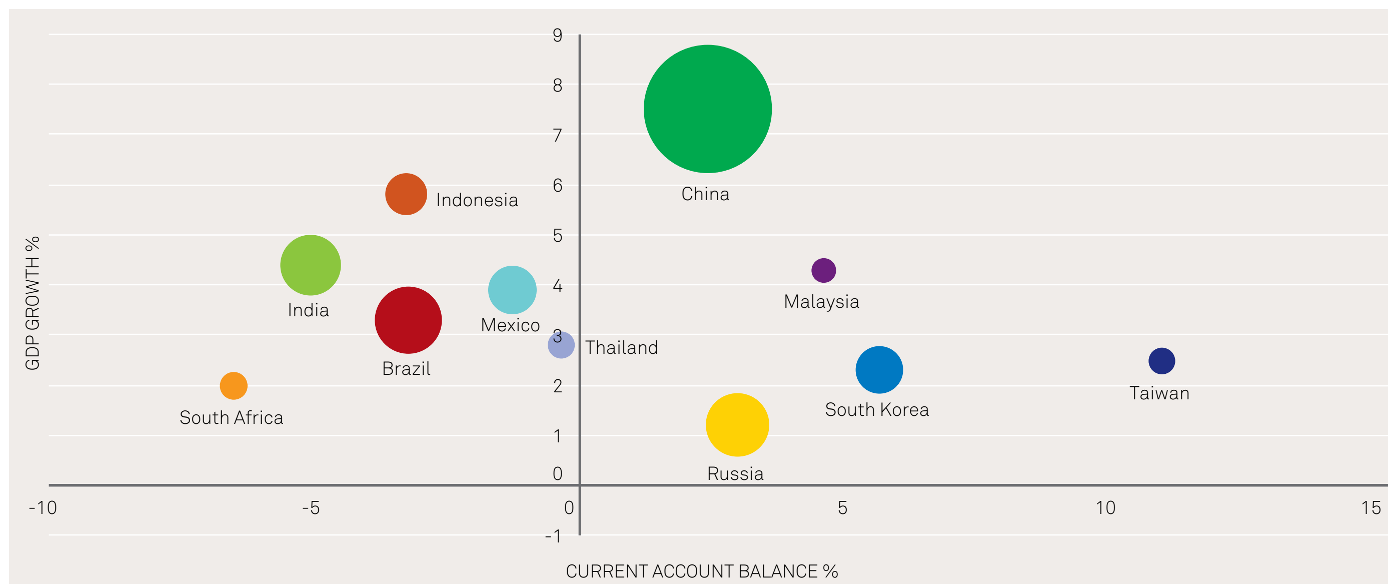
However some investors remain concerned that tighter US monetary policy in the future will set off instability in some emerging markets economies.

This leaves invetsors with a dilemma – take advantage of lower valuations to invest in emerging markets, or avoid the asset class due to concerns about the current acount balances in some countries?

Is the answer to do a little of both?

The chart on the next page compares the GDP growth rate with the current account balance of the 11 largest coutries in the MCSI Emerging Markets Index. Investors looking to invest in emerging markets economies, but wary of countries with current account deficits may want to consider investing directly in individual countries, rather than in the broad index exposure.

Invetsors looking for GDP growth, coupled to a current account surplus will want to focus on those economies further to the top right hand side of the chart, such as South Korea, Taiwan and China.



iShares offers investors the opportunity to access several emerging markets economies directly through the iShares MSCI South Korea Capped ETF (IKO), iShares MSCI Taiwan ETF (ITW) and iShares China Large Cap ETF (IZZ). Iinvetsors also have the choice of investing in a broad allocation to emerging markets through the iShares MSCI Emerging Markets ETF (IEM).

FOR MORE INFORMATION

Visit our website at iShares.com.au
Call 1300 474 273

IMPORTANT INFORMATION

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