



Emerging Markets: The Trade of the Decade? – May 2019

By Todd Bassion, Portfolio Manager

May 2019

GVA has exposure to emerging markets through the following areas:

- Emerging Markets portfolio
- International Small Cap: Currently overweight emerging markets
- Global All Cap: Currently overweight emerging markets
- We also have exposure to emerging markets through developed market names, with operations in the region.

The last decade has produced close to zero returns for emerging markets, but we believe that we are now entering a very attractive point in the cycle. Our main reasons for optimism stem from the following factors:

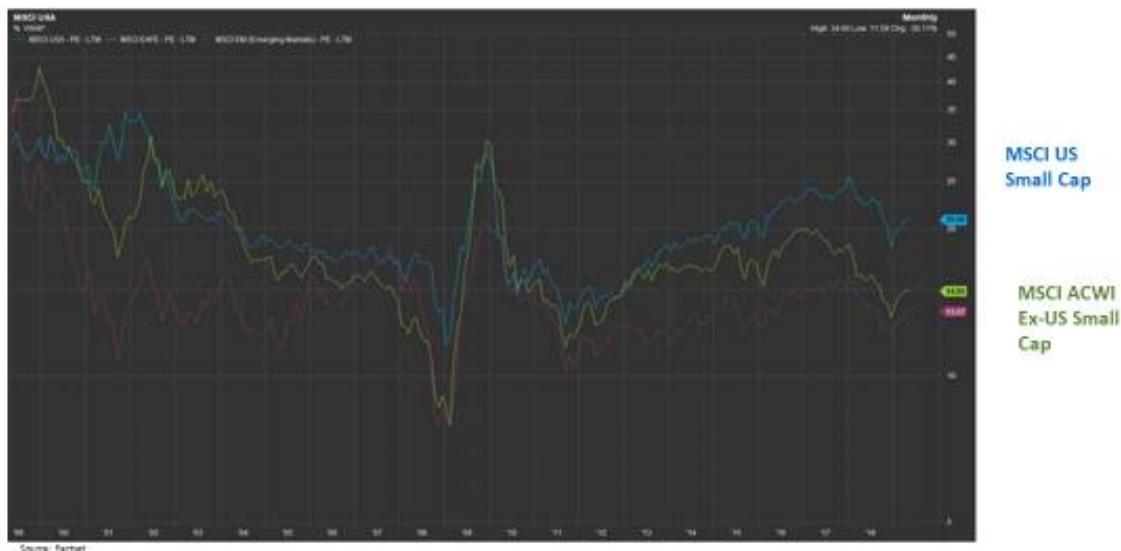
- Valuation: The valuation gap has widened over the last decade, with emerging markets looking especially cheap. PE LTM in EM is now 13x vs 20x in the US. We believe this valuation gap will narrow over time.
- Performance: We are currently in the “lost decade” for emerging markets. Total return for emerging markets this decade in US dollar terms is close to zero, while US markets have doubled in value. This is a complete reversal from last decade (2000-2010), where US market performance was close to zero, and emerging markets doubled in value.
- Growth vs Value: Growth has consistently outperformed value over the last decade in Emerging Markets, which is not sustainable. We are now back to 2000 levels of relative outperformance.
- GDP: The US accounts for roughly 25% of global GDP, but more than half the global market cap. Emerging markets are the opposite, accounting for close to 40% of global GDP and close to 10% of the global market cap. In terms of global market cap, this has always been the case that emerging markets are underrepresented, but this is the lowest representation in more than a decade. We believe it is likely to see a reversal of this trend over the next decade, with emerging markets outperforming. Note that emerging markets have also been the main driver of global growth over the last decade.
- US Dollar: One of the reasons emerging markets has been a weak performer this decade is because the dollar has been strong. The US dollar was relatively cheap at the beginning of this decade, and now appears relatively expensive vs most currencies in the world. When the momentum of the dollar turns, emerging markets are likely to outperform. Currencies tend to run in long cycles. If you look at post Bretton-Woods history since the early 1970s when we moved to a freely floating exchange rate mechanism, the dollar has been holding in a range and has run in up and down cycles lasting 5-8 years in duration. We are currently in the 8th year of a bull run in the dollar. We believe the next 5-8 years will see a reversal in this trend.



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Emerging Markets Look Well Positioned: Valuation Gap Widening Over Time



Summary: This chart compares the total return of the MSCI All Country World ex-US Small Cap Index and the MSCI US Small Cap Index for the last two decades. The two indices had nearly identical returns through 2009, but then US stocks dramatically outperformed the following decade. This trend seems unlikely to repeat.

Emerging Markets Look Well Positioned

The "lost Decade" for Emerging Markets



Source: Factset

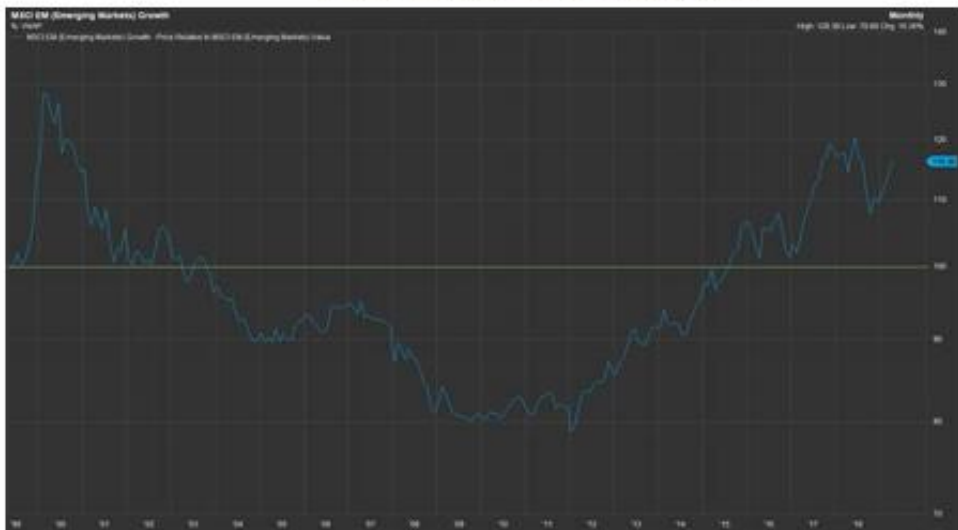


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Emerging Markets Look Well Positioned

Growth vs Value will eventually turn

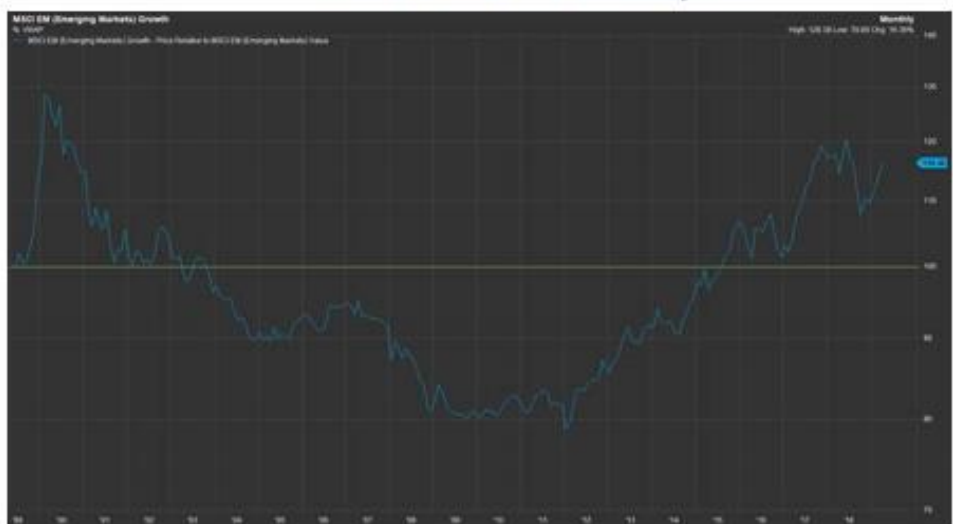


Source: Factset. Price returns in USD, through May 30, 2018. MSCI Growth vs MSCI Value.

Summary: We are back to 2000 levels of growth outperforming value

Emerging Markets Look Well Positioned

Growth vs Value will eventually turn



Source: Factset. Price returns in USD, through May 30, 2018. MSCI Growth vs MSCI Value.

Summary: We are back to 2000 levels of growth outperforming value



Emerging Markets Look Well Positioned

Market caps are heavily skewed toward developed markets

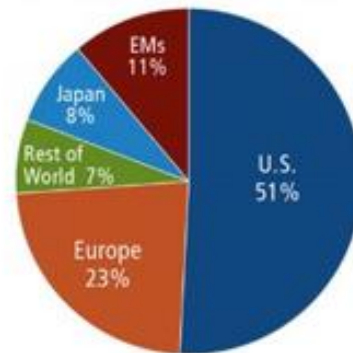
THE CASE FOR GLOBAL ASSET ALLOCATION

The lion's share of global GDP comes from outside the U.S., and U.S. companies make up just over half the stock market.

ESTIMATED % OF 2017 GLOBAL GDP



COMPOSITION OF GLOBAL STOCK MARKET

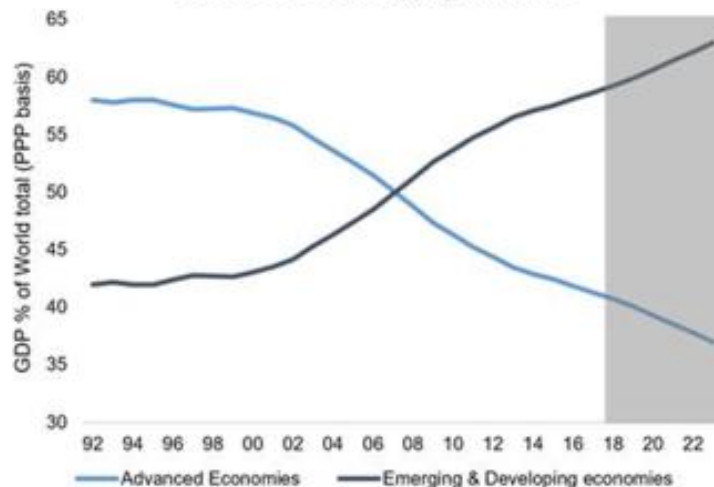


Source: International Monetary fund, Oct 2017 database. Market Cap data from MSCI ACWEI Index (as of 10/31/17).

Emerging Markets Look Well Positioned

Emerging markets have been the main driver of global growth over the last decade

The rise of emerging markets



Source: www.topwowncharts.com



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