

Schroders



Schroders Emerging Markets Lens: Equity

Strategic Research Unit

February 2023

Marketing material for professional investors or advisers only.

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Summary

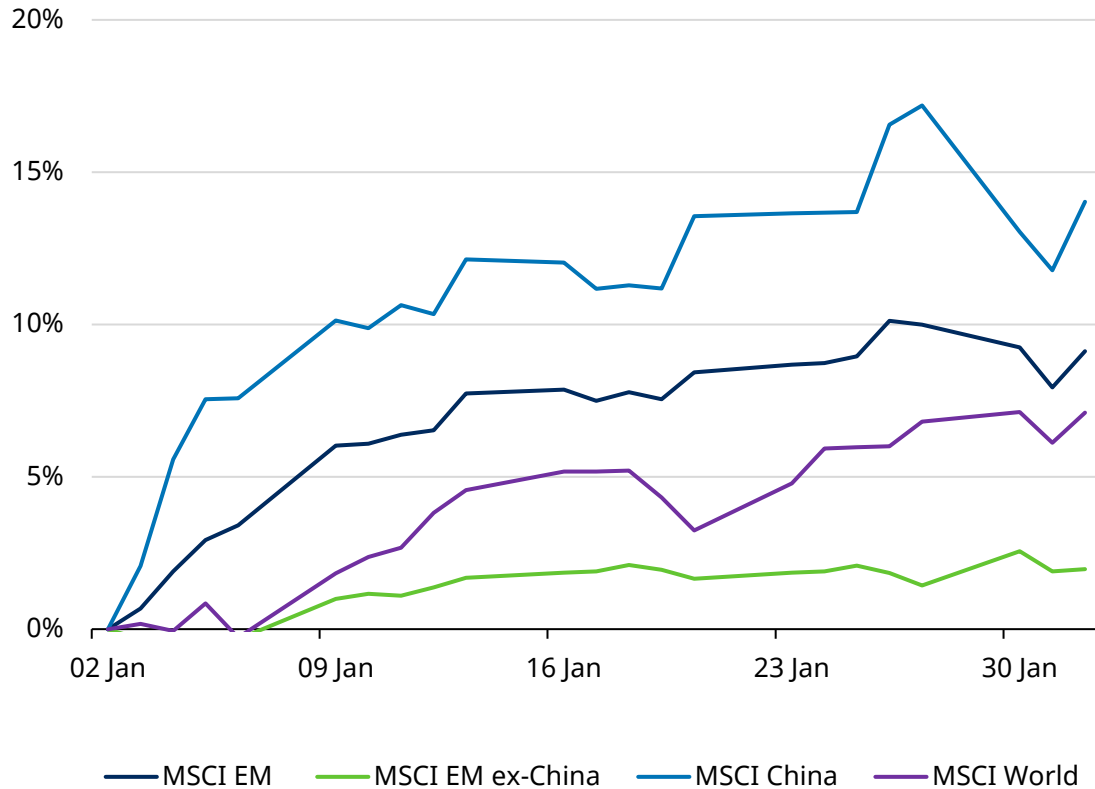
- Emerging Market (EM) equities have made a strong start to 2023, aided by the rally in China.
- Positive sentiment towards reopening, and a fall in regulatory concerns have been the main drivers of the rebound in China. Read more here: [China's 50% rebound: it's not just about Covid.](#)
- After the recent rally and downward revisions to 2023 earnings expectations EM equities are no longer cheap on a forward P/E basis. The price-book ratio is close to its historical median. On a dividend yield basis, EM remains cheap versus history.
- There remains considerable variability between sector valuations in EM. Various growth sectors 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.
- On a regional basis, Latin America remains cheap on a forward price-earnings basis. Valuations in Asia and EMEA are above their historical median.
- 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.

*EMEA is Europe, the Middle East and Africa

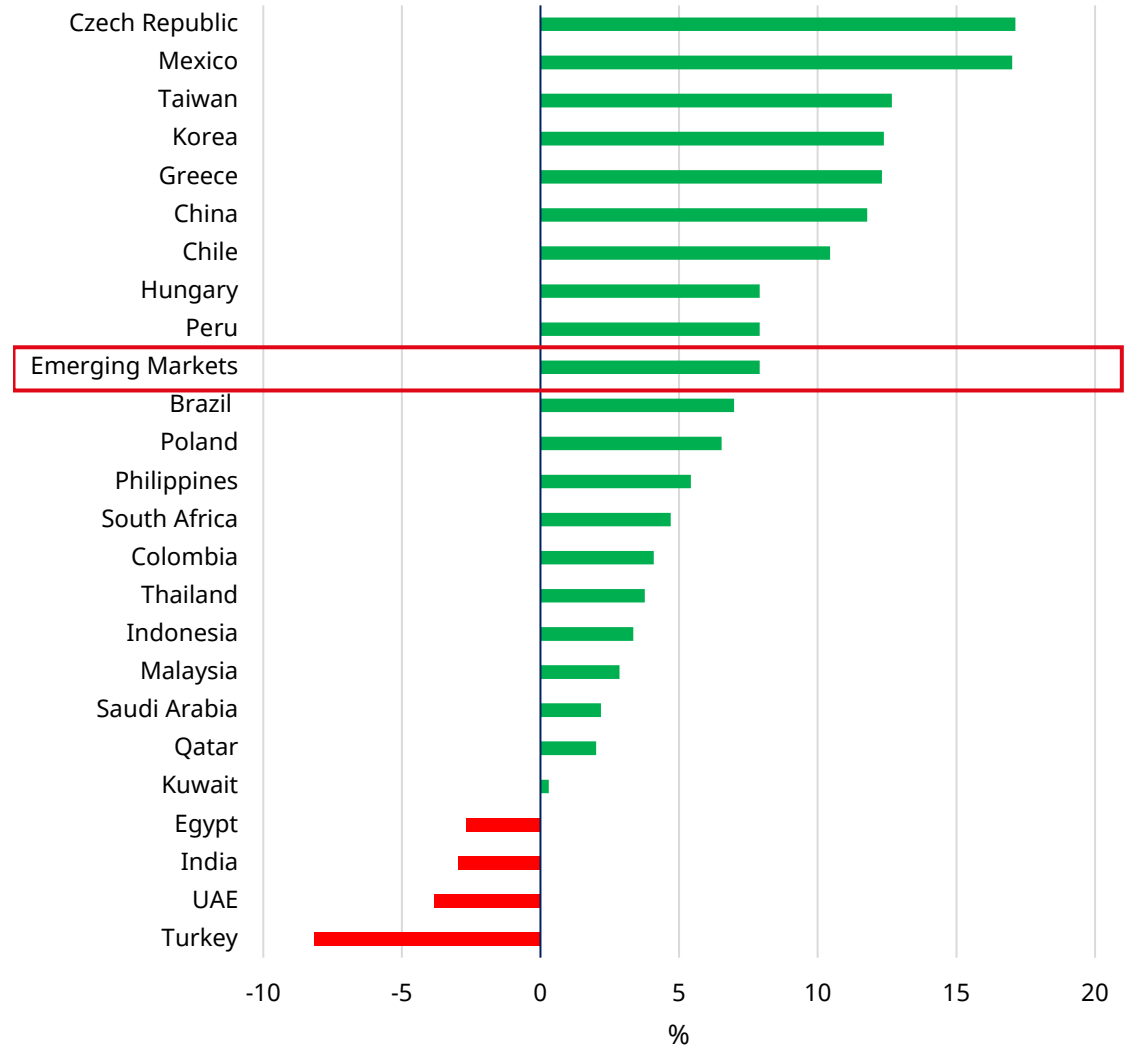
EM equities have made a strong start to 2023

... helped by the China rally

YTD EM 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 1 February 2023.

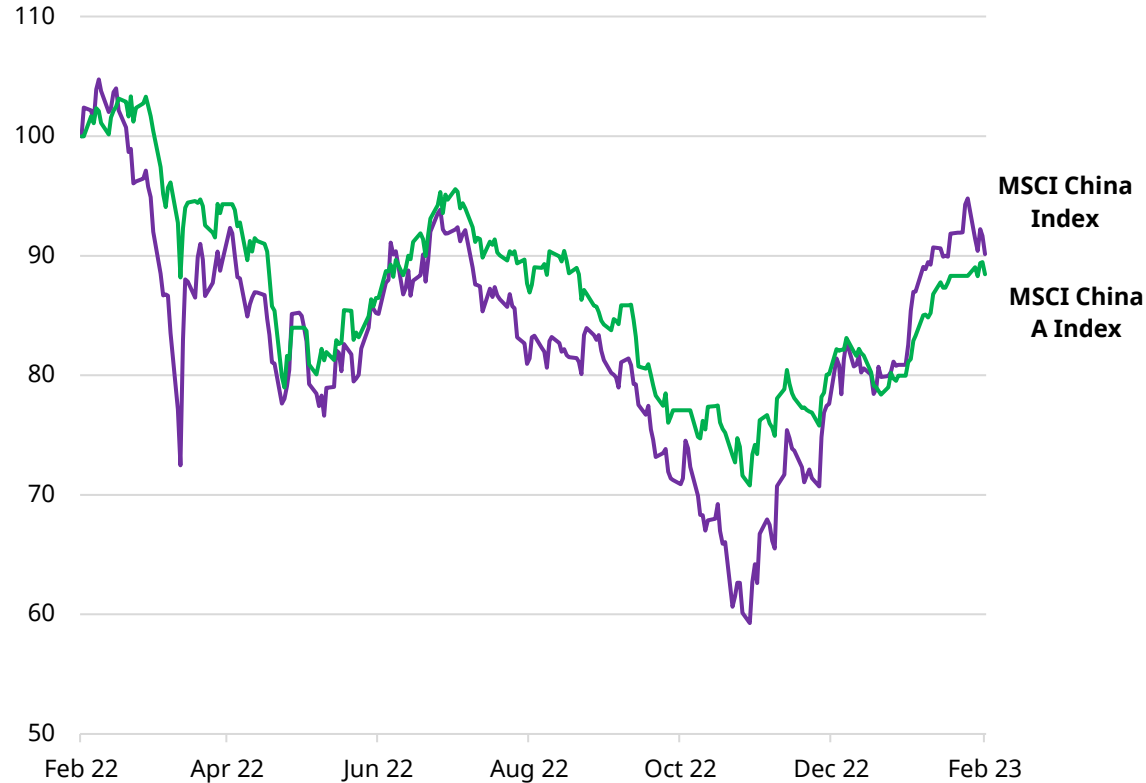


Past performance is not a guide to future performance and may not be repeated.
 Percentage total return, US dollars.
 Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit, as at 31 January 2023.

Net flows into mainland China have hit record highs

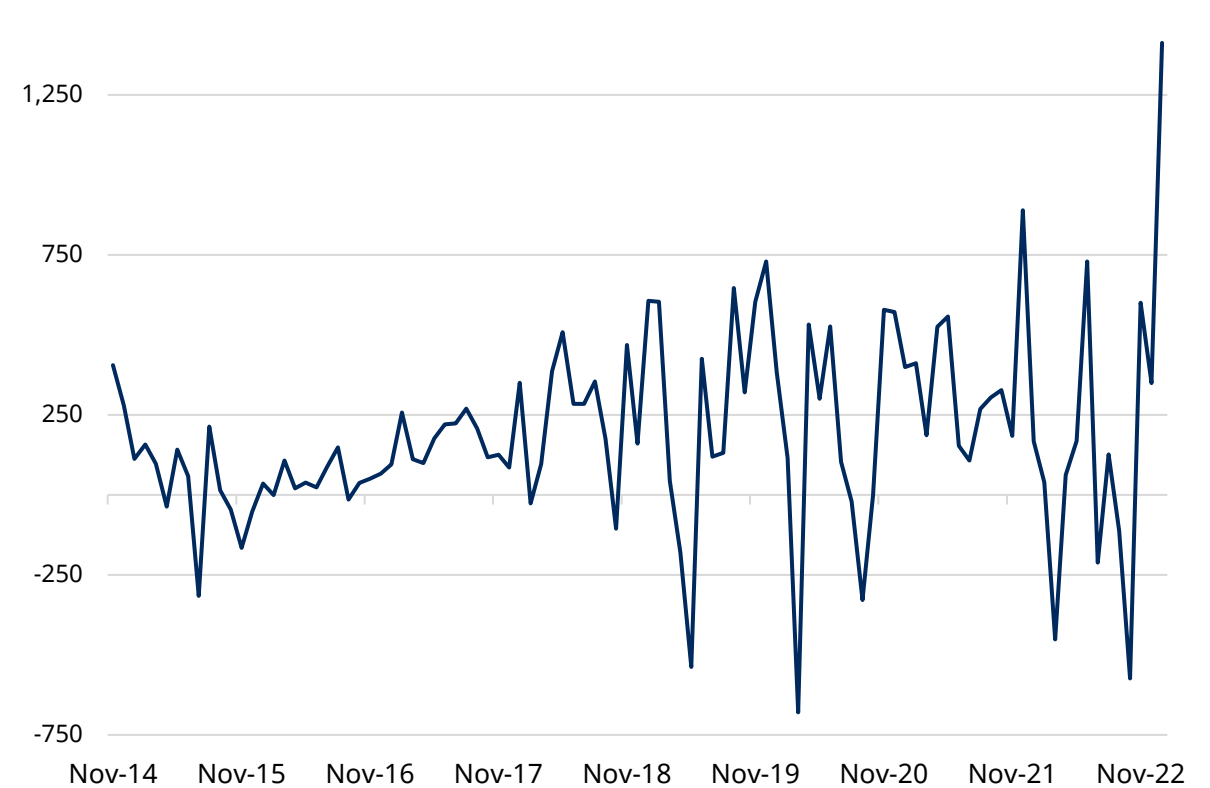
... helped by the China rally

China's reopening rally



Past performance is not a guide to future performance and may not be repeated.
Total return, US dollars. MSCI China A Index includes large and mid-cap stocks listed in Shanghai and Shenzhen. Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit, as at 1 February 2023.

Record net monthly northbound Stock Connect flows



Past performance is not a guide to future performance and may not be repeated.
Net Northbound flows, RMB million (Shenzhen and Shanghai)
Source: CICC, Schroders Strategic Research Unit. Data as at 2 February 2023



Emerging market equity performance

A challenging decade for EM versus DM

Could this be set to finally abate?

EM vs DM (total return, rebased to 100)



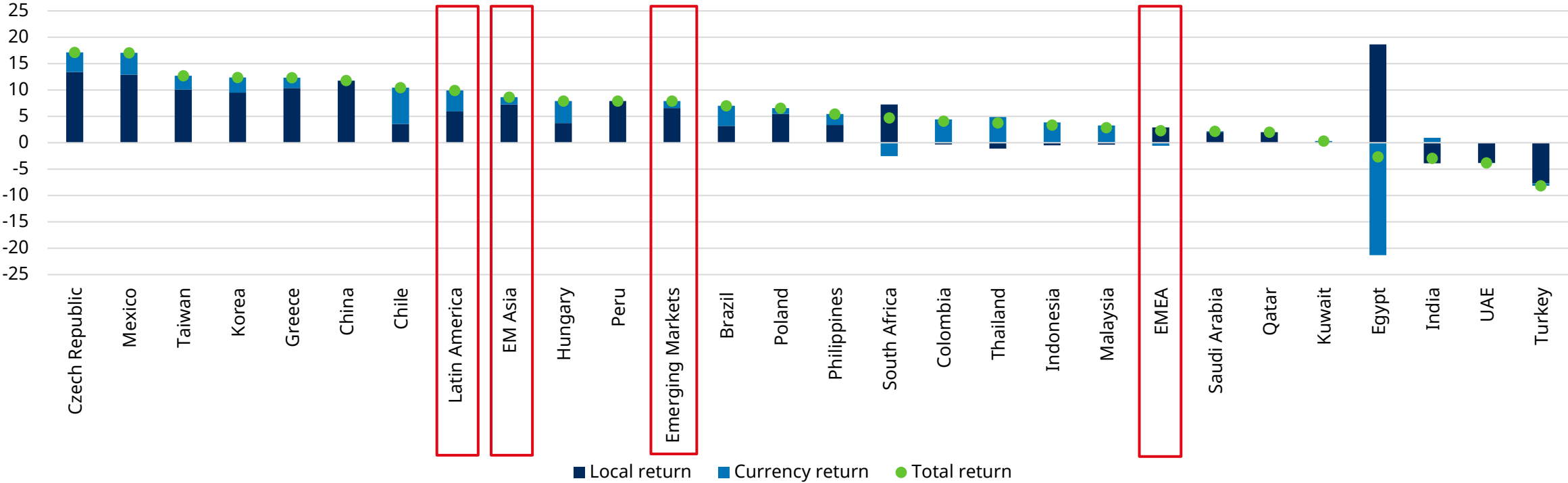
The longer term trend of underperformance versus DM started in 2011

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 January 2023. All returns in USD terms.

Significant variability in EM performance

YTD returns in EM equity markets, US dollar terms



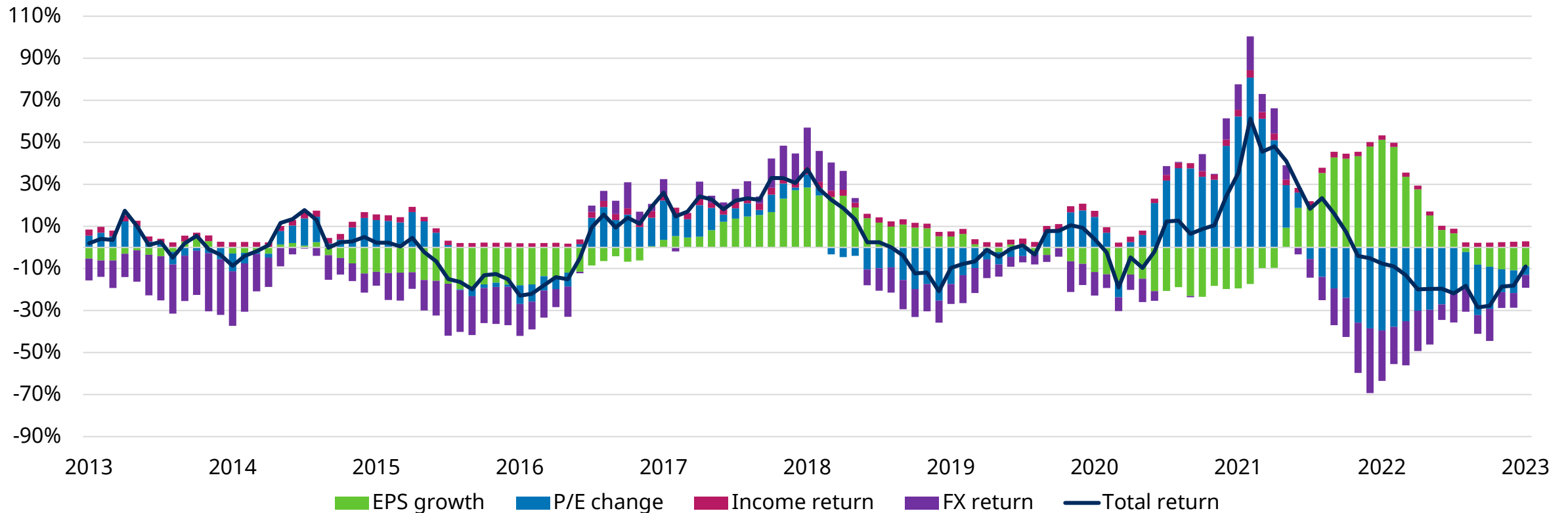
Latin America and EM Asia lead YTD

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 January 2023.

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 was negative due to EPS growth, contracting P/E multiple, and currency losses

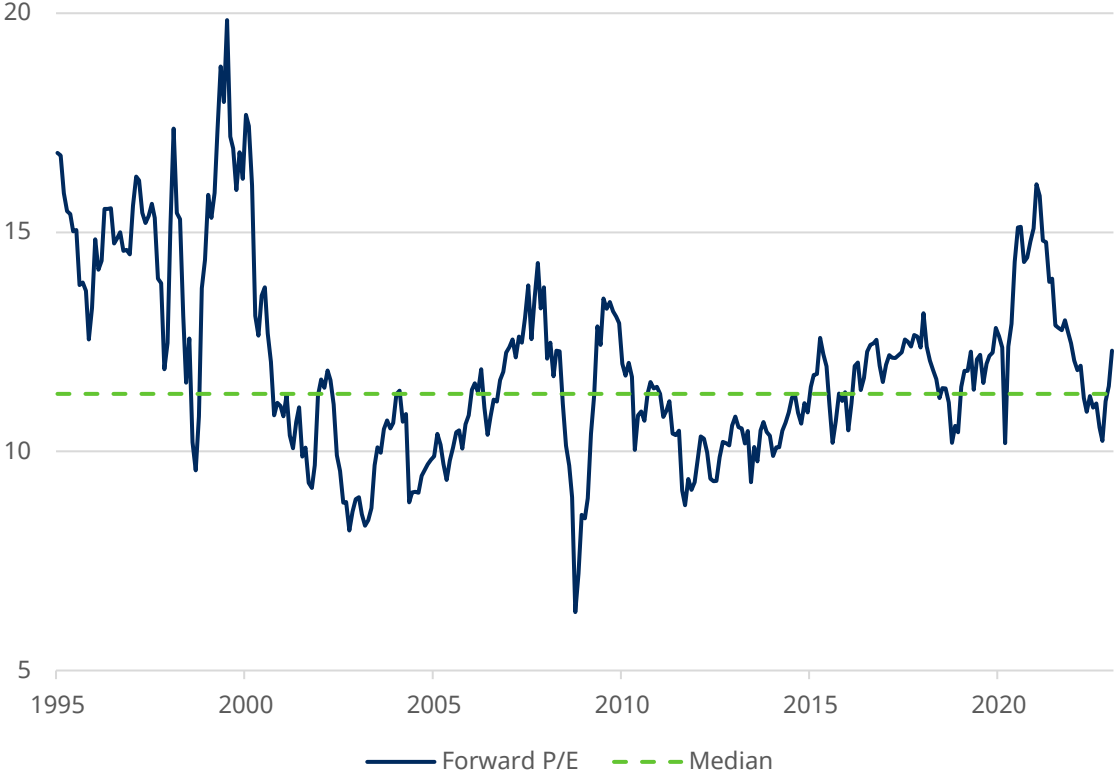
Past performance is not a guide to future performance and may not be repeated.
Source: Schroders, Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 January 2023.



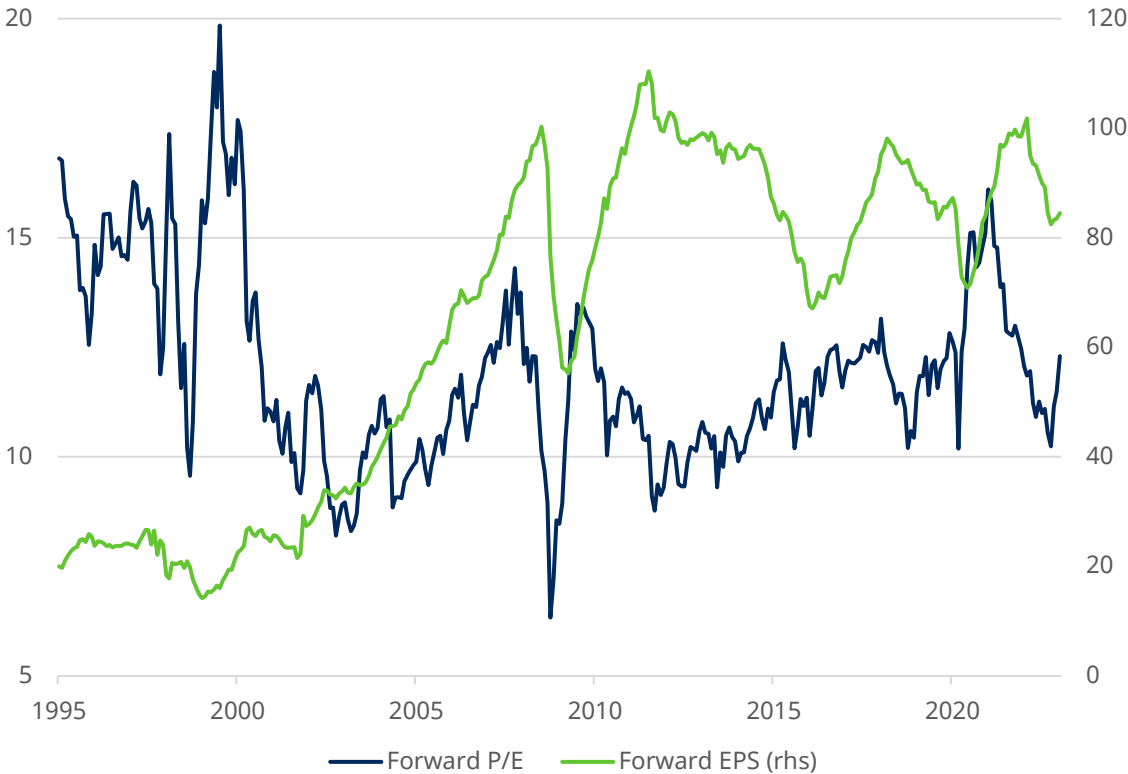
Emerging market equity valuations

EM equities are no longer cheap on a forward P/E basis

The MSCI EM Index 12-month forward P/E



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

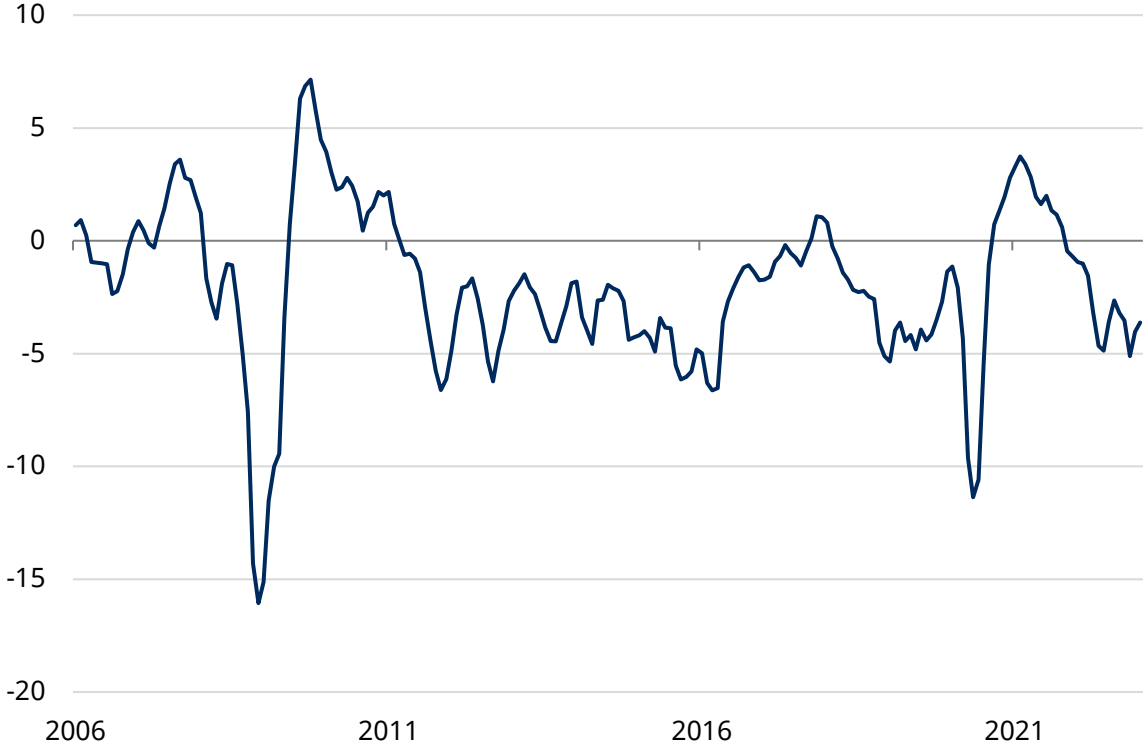


Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

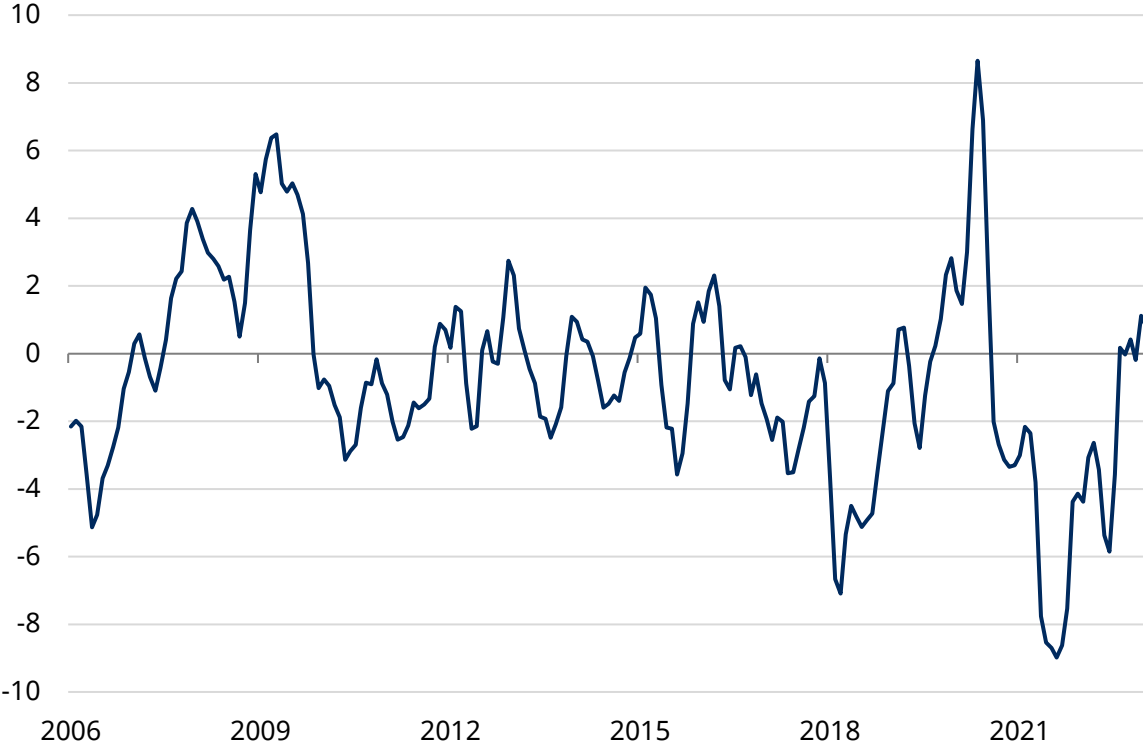
EM earnings revisions are still negative

...but are positive relative to DM

EM earnings revisions¹ (3-month average)



EM minus DM earnings revisions

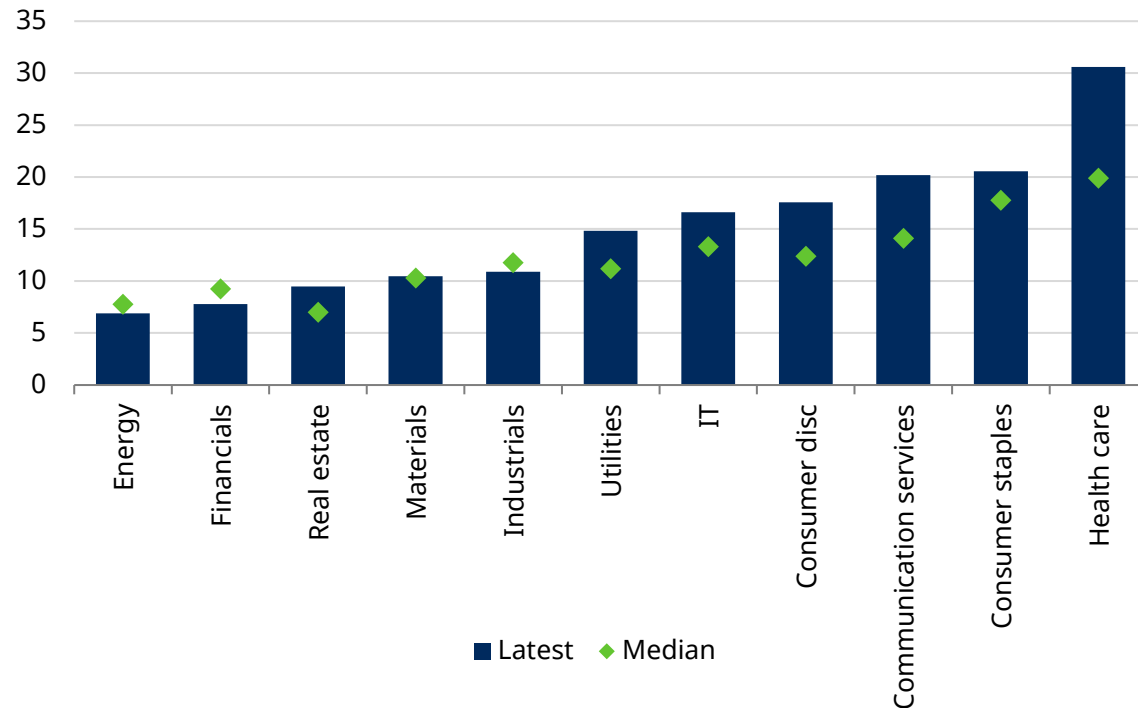


Calculated as the number earnings upgrades minus the number of earnings downgrades divided by the total numbers of earnings updates.
Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

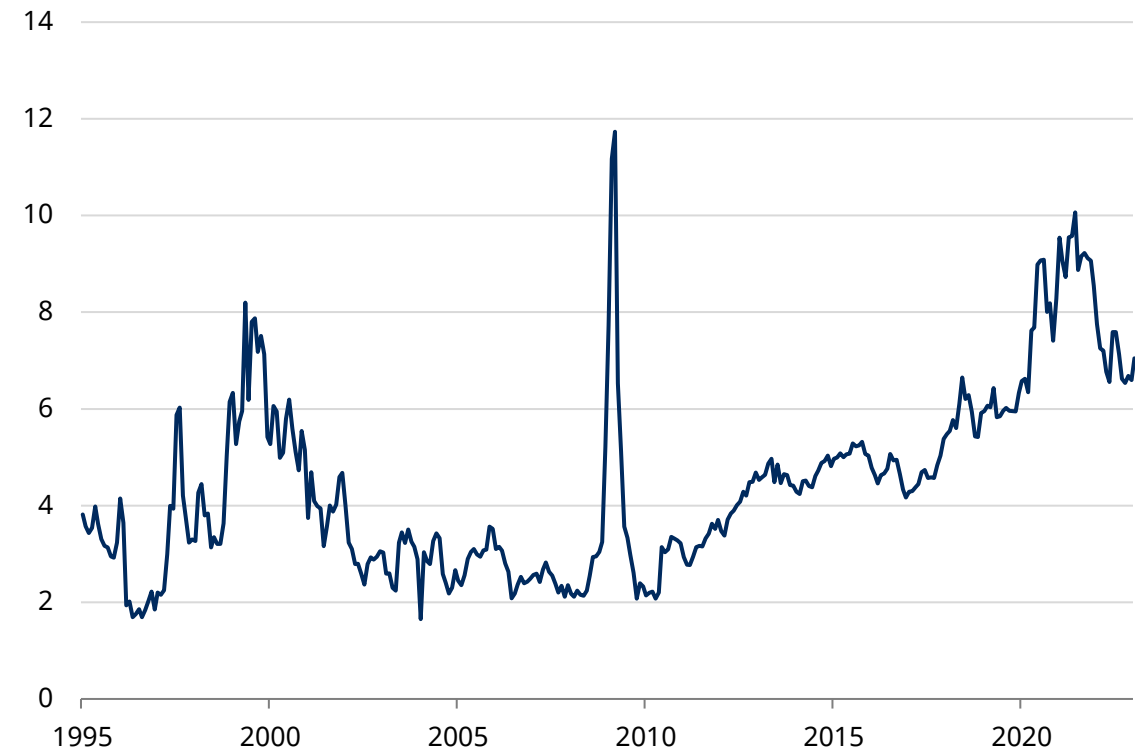
Variability in sector valuations remains high

Various 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

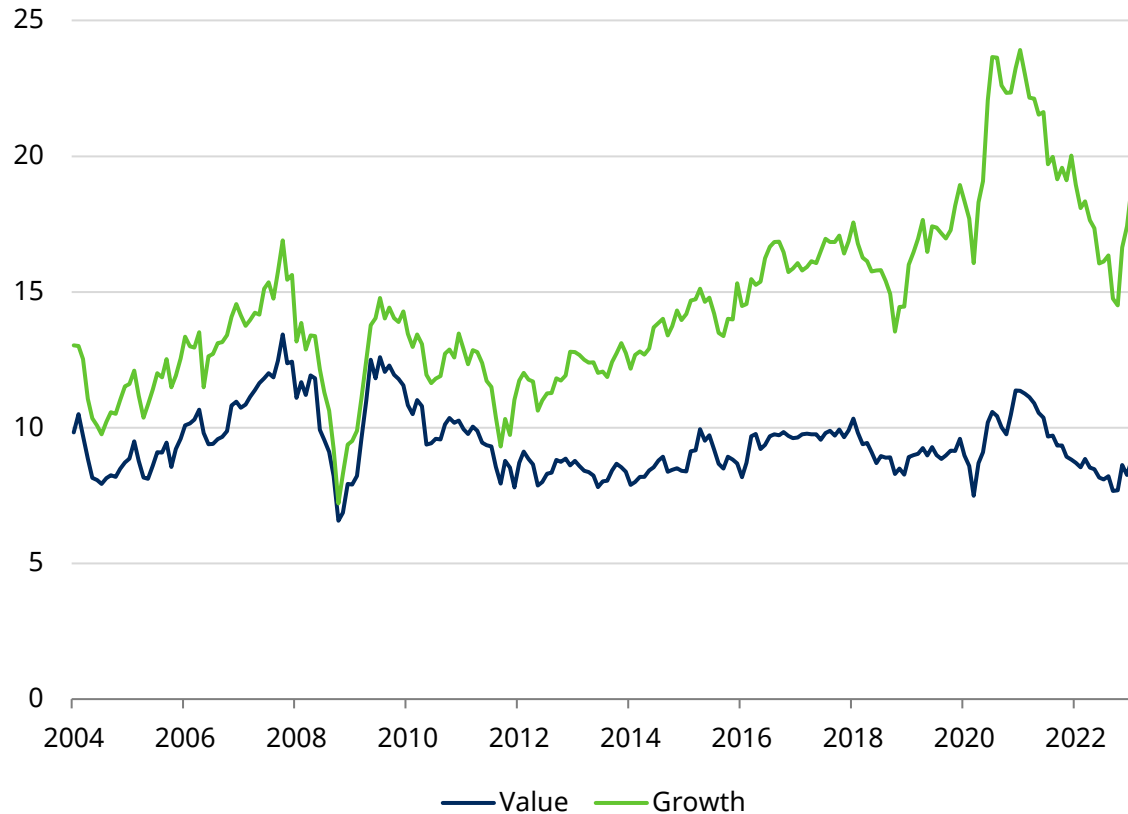


A majority of EM sectors have re-rated in the past month

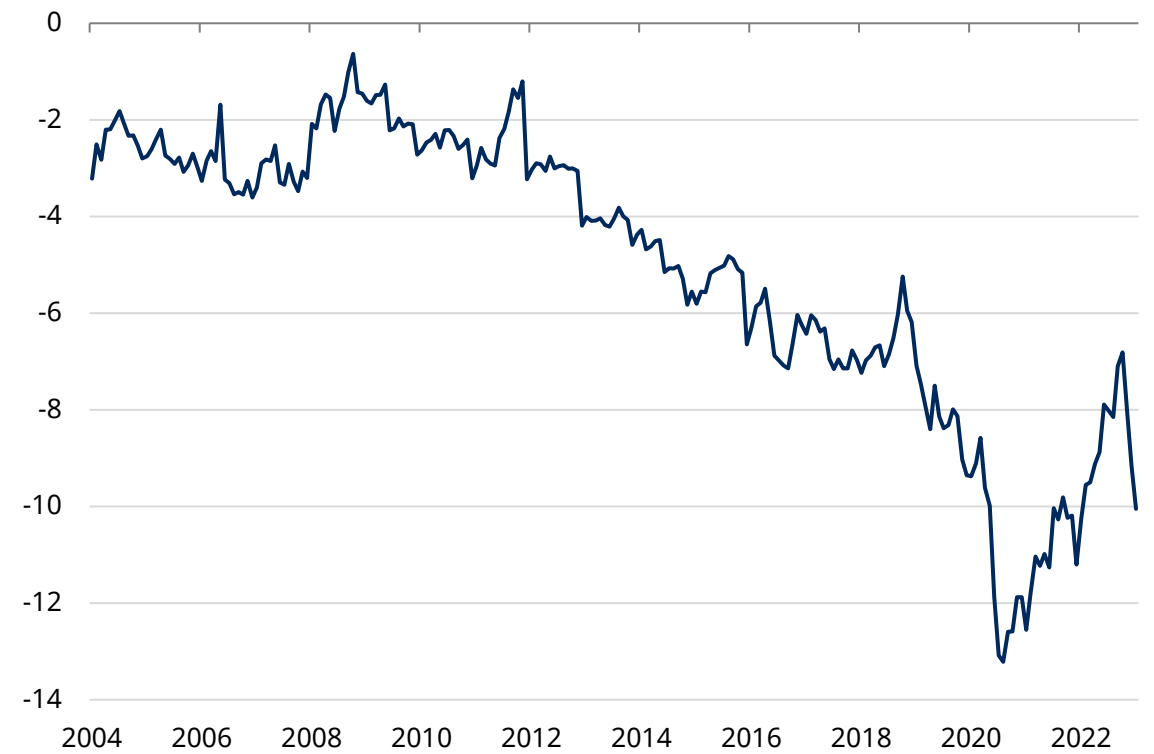
Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023. Median since January 1999.

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



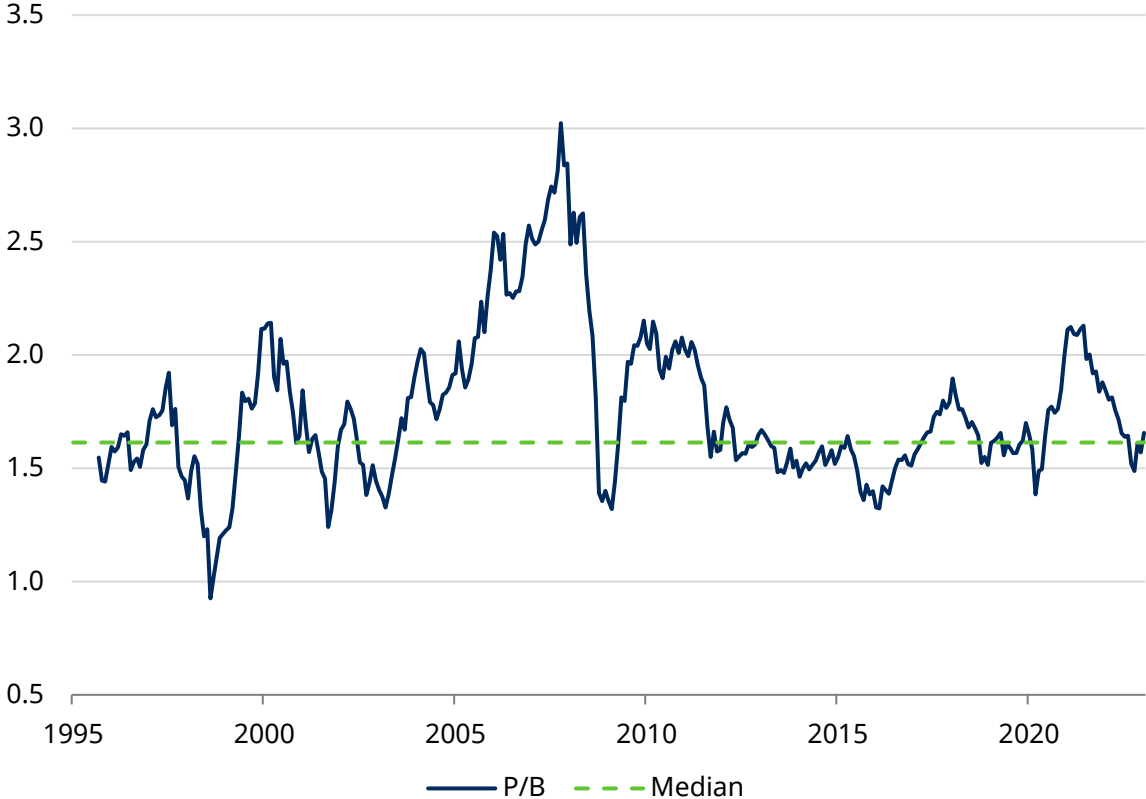
Recent Growth re-rating ended the trend which had seen Value's discount narrow since 2020

Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 January 2023

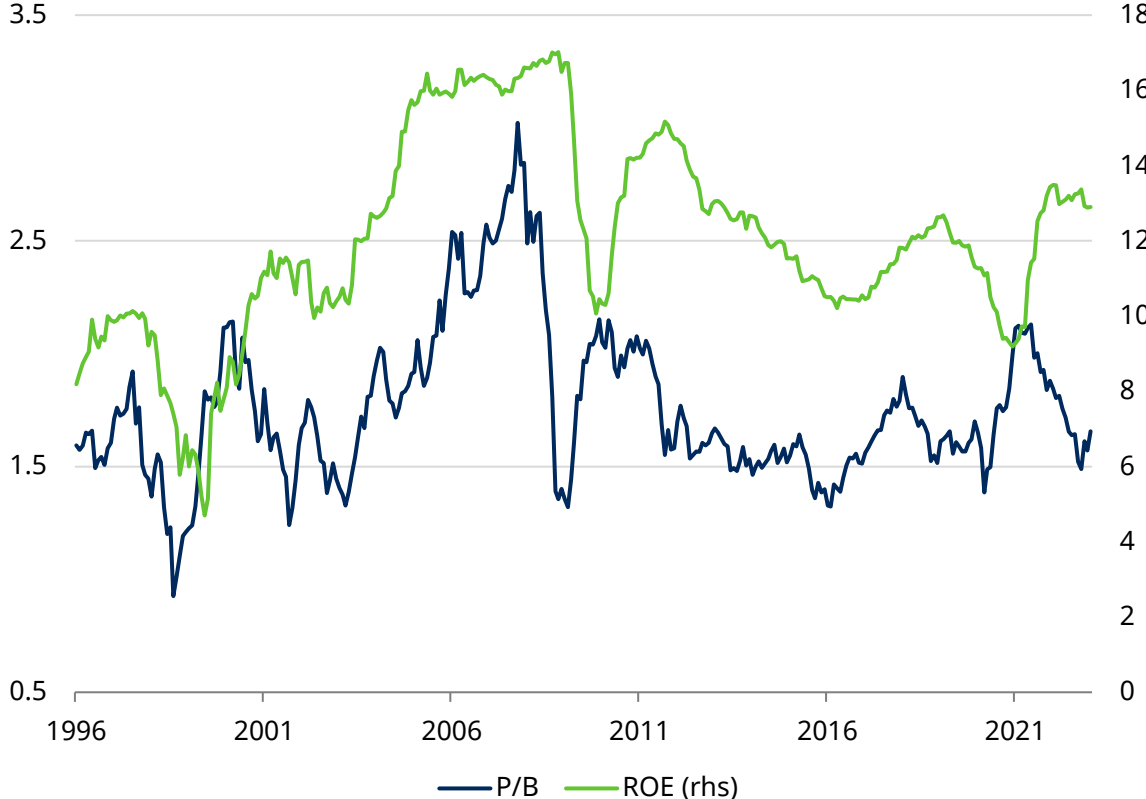
Other valuation metrics: price-to-book ratio

The P/B ratio is close to the historical median

The MSCI EM Index P/B



The MSCI EM Index P/B and ROE

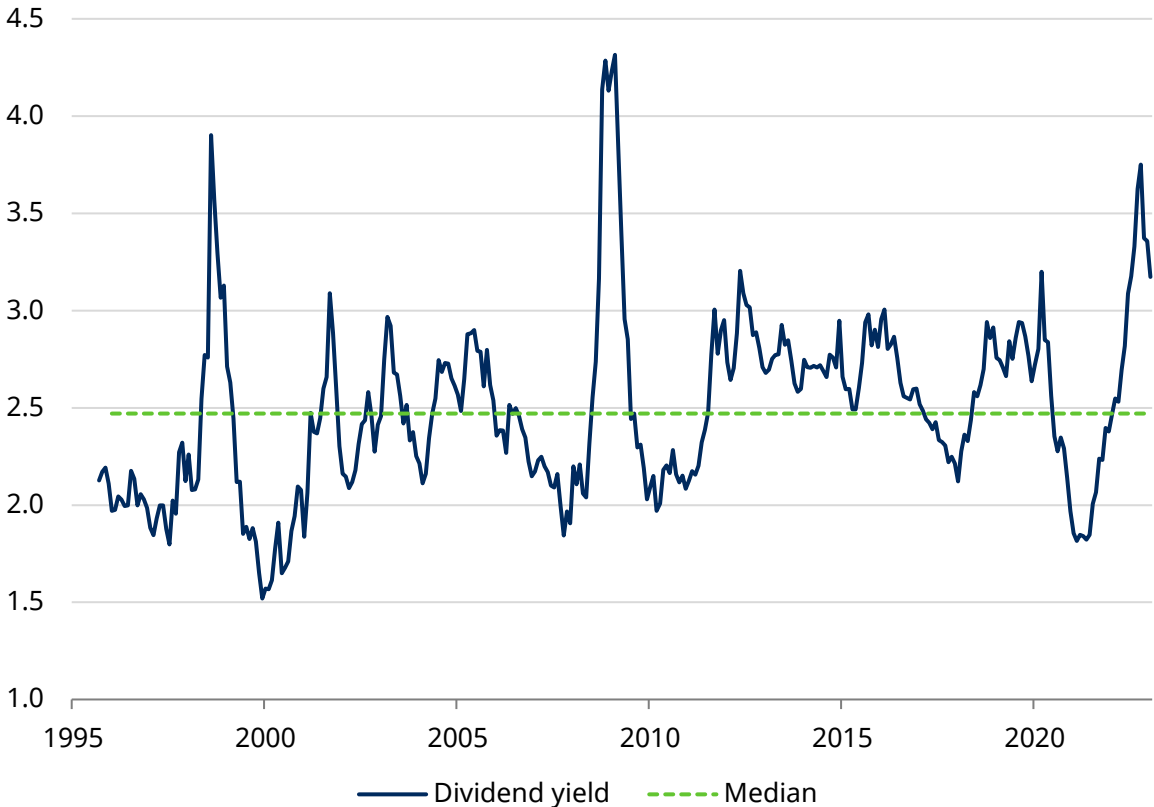


Source: Refinitiv Datastream, Schroders Strategic Research Unit, MSCI. Data as at 31 January 2023.

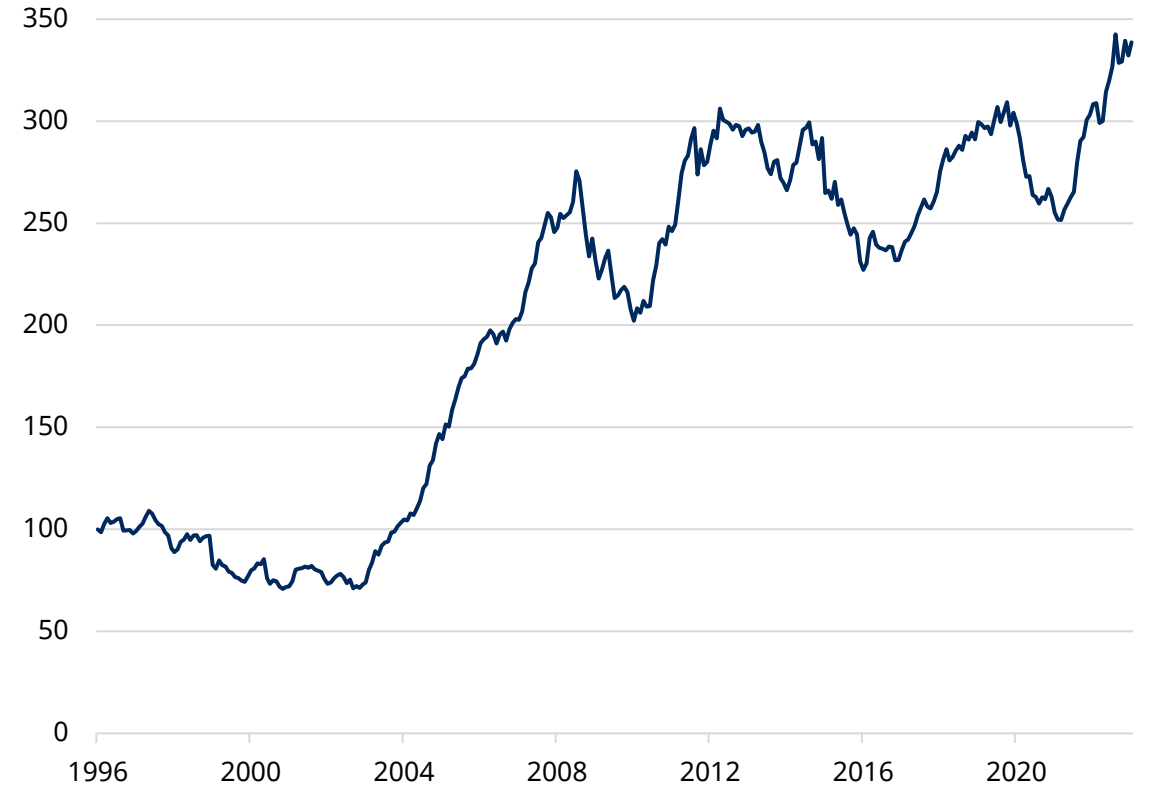
Other valuation metrics: the dividend yield

EM dividend yield is still well above the historical median

The MSCI EM Index dividend yield (%)



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



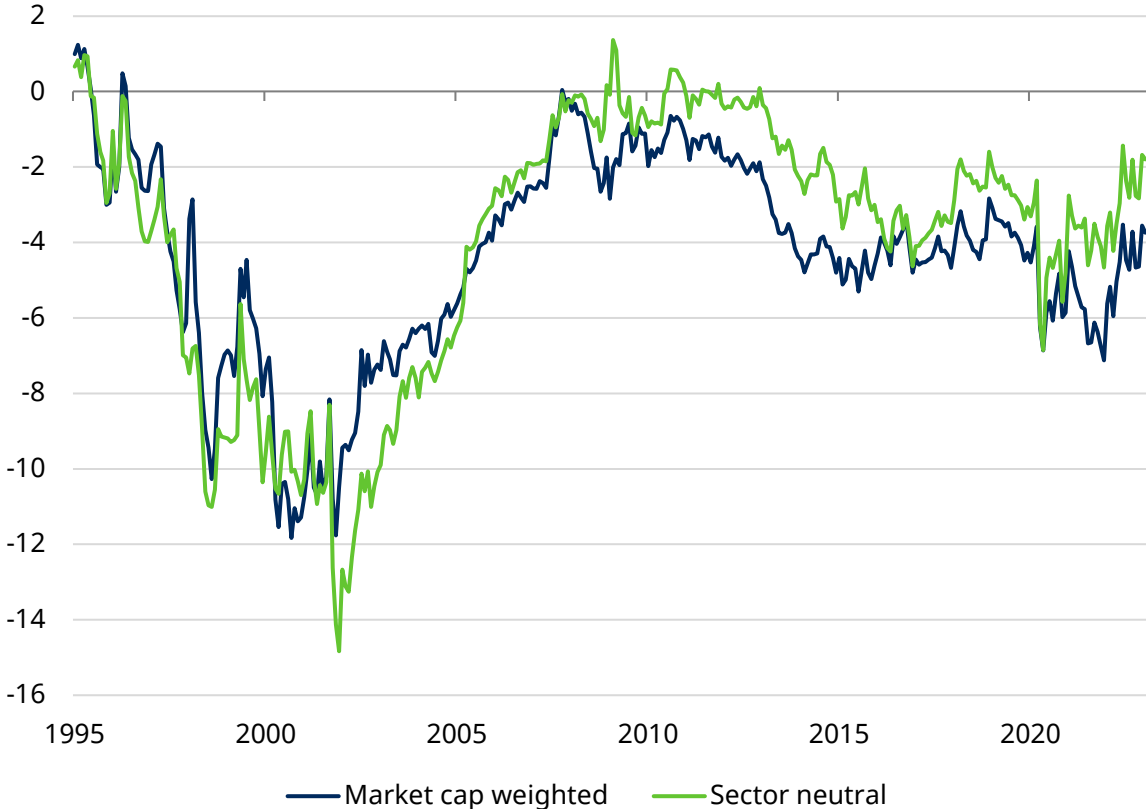
Despite the recent pullback, EM dividend yield remains elevated

Source: Refinitiv Datastream, Schroders Strategic Research Unit, MSCI. Data as at 31 January 2023.

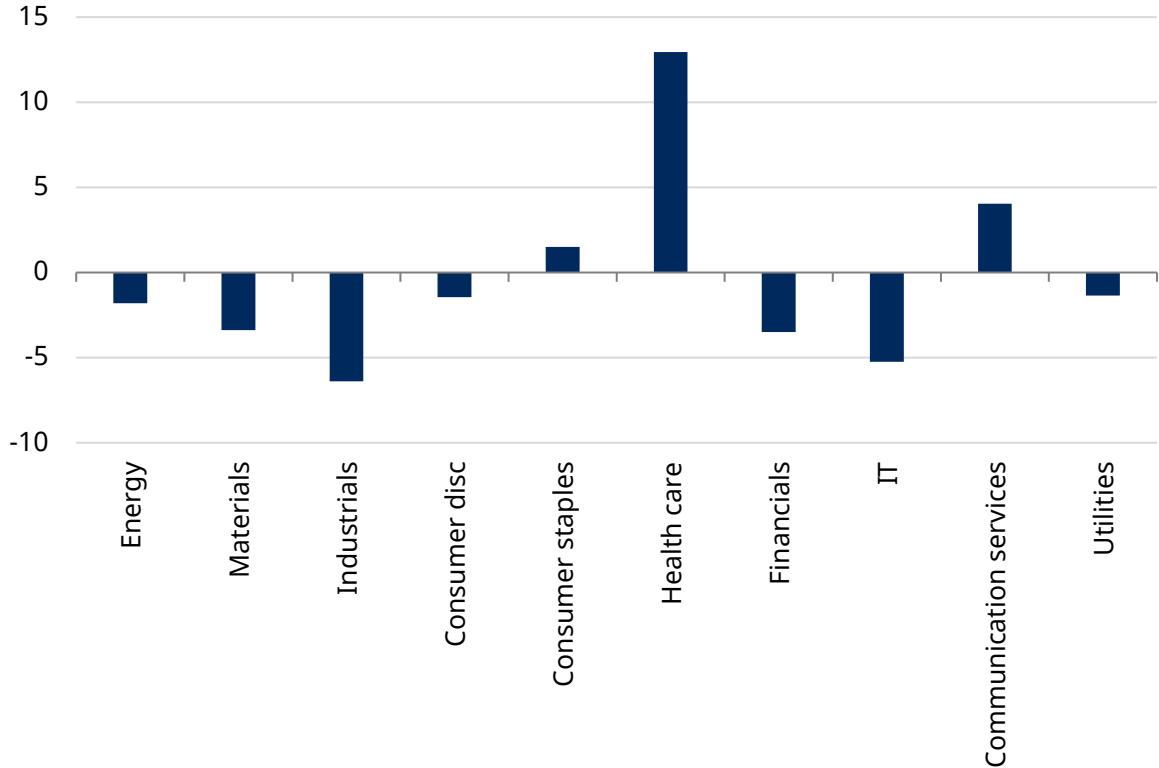
Emerging versus developed market valuations

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/E of sectors



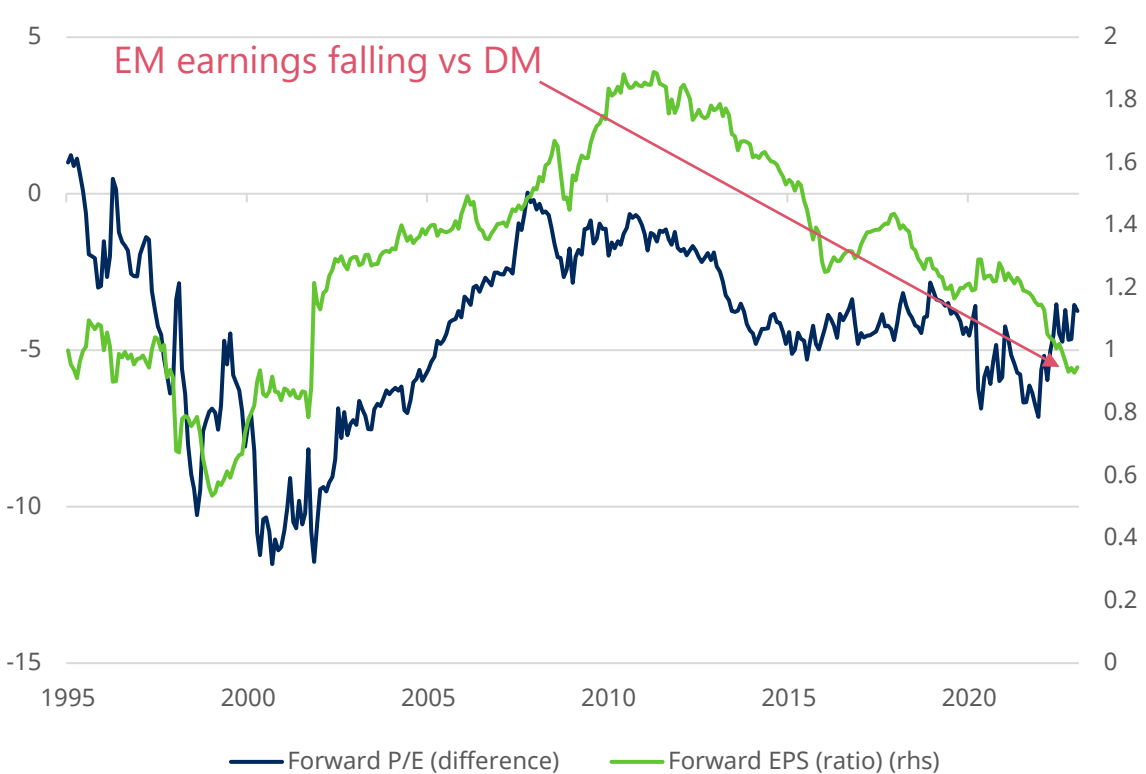
EM sector neutral valuation gap to DM narrowed in 2022

Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

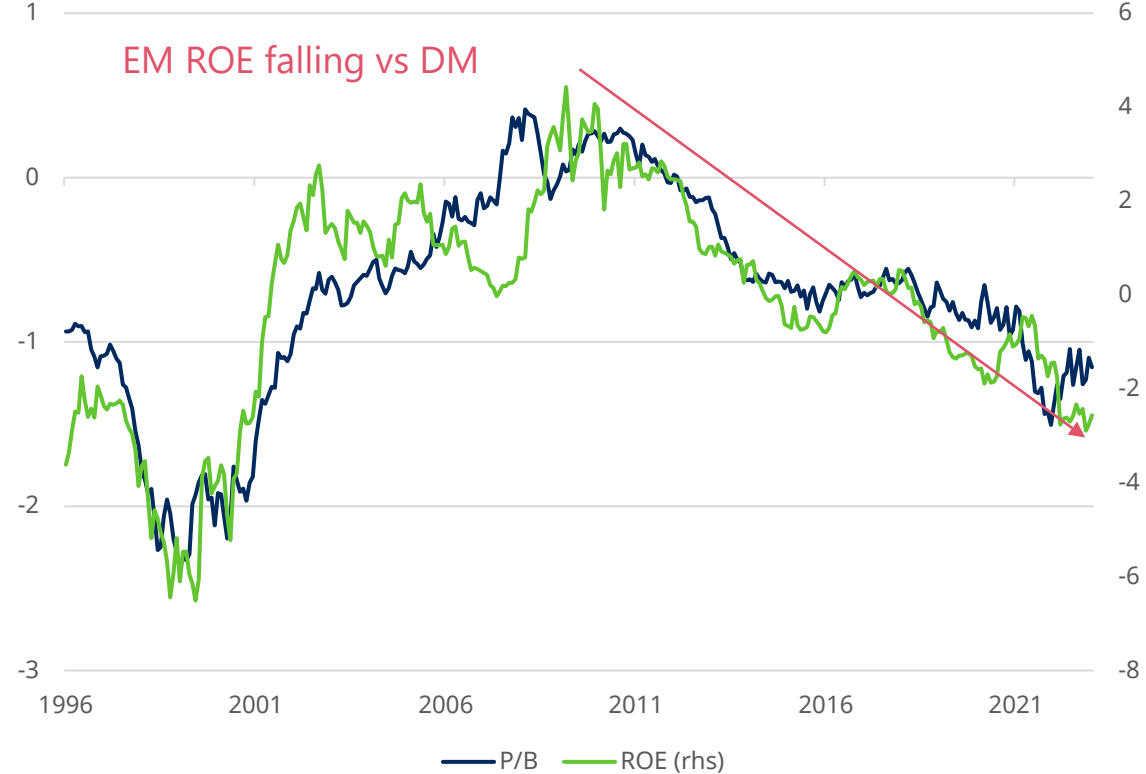
Drivers of EM/DM valuation gap

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 January 2023.

Emerging markets index composition

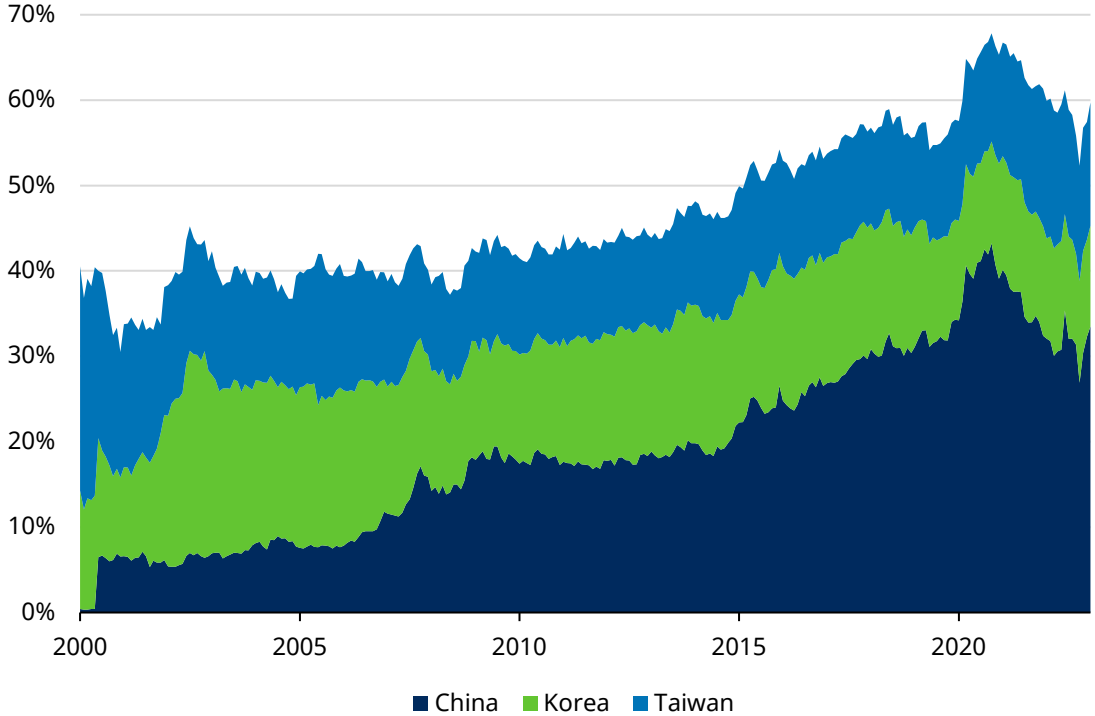
EM is dominated by Asia

The MSCI EM Index share of regions



■ Asia ■ EMEA ■ Latam

China, Korea and Taiwan are close to 60% of the EM index

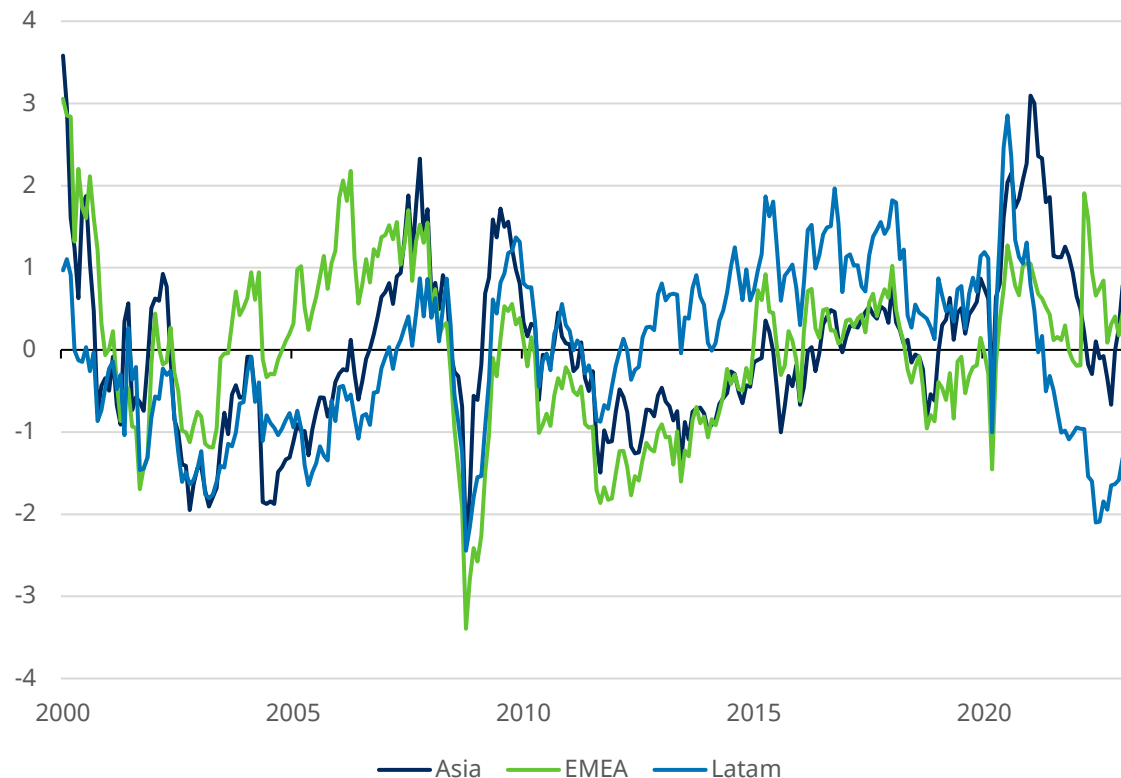


Three large North-east Asia markets have a big impact on aggregate EM valuations

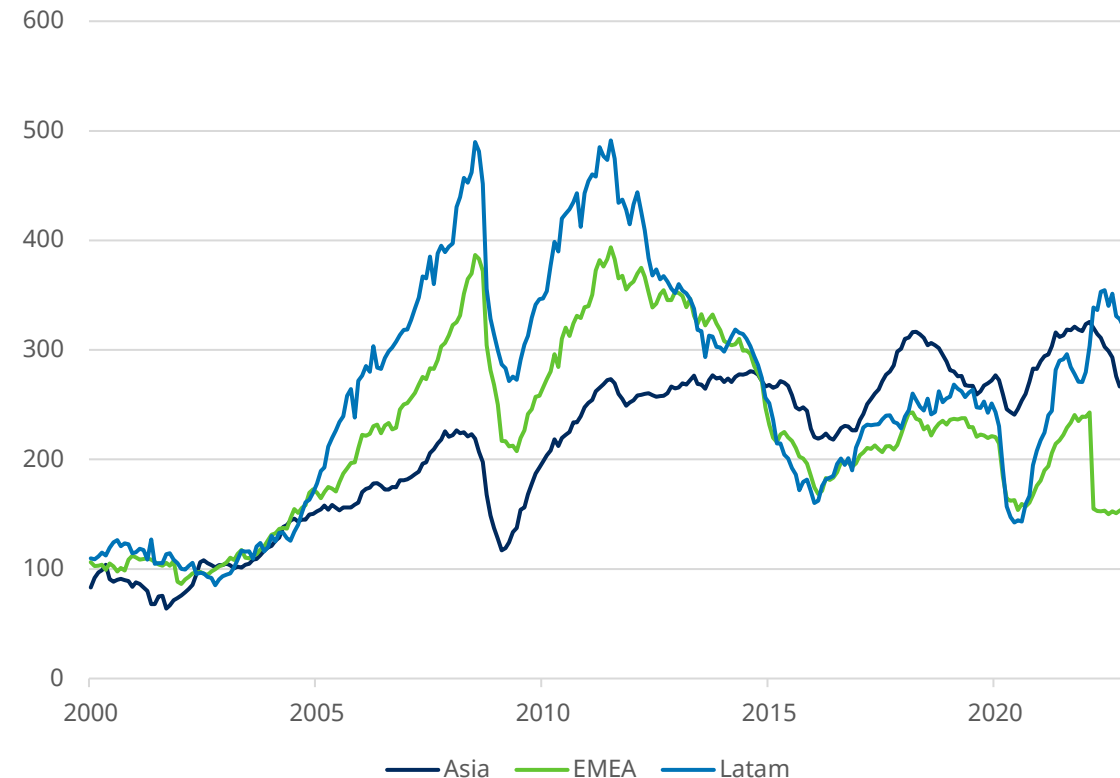
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 January 2023.

Valuations and earnings expectations in EM regions

Standardised 12-month forward P/E (z-score¹)



12-month forward EPS of EM regions



Latin America is the cheapest region. Valuations in Asia and EMEA are above their historical averages

Source: Refinitiv Datastream, Schroders Strategic Research Unit, MSCI. Data as at 31 January 2023. ¹The 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



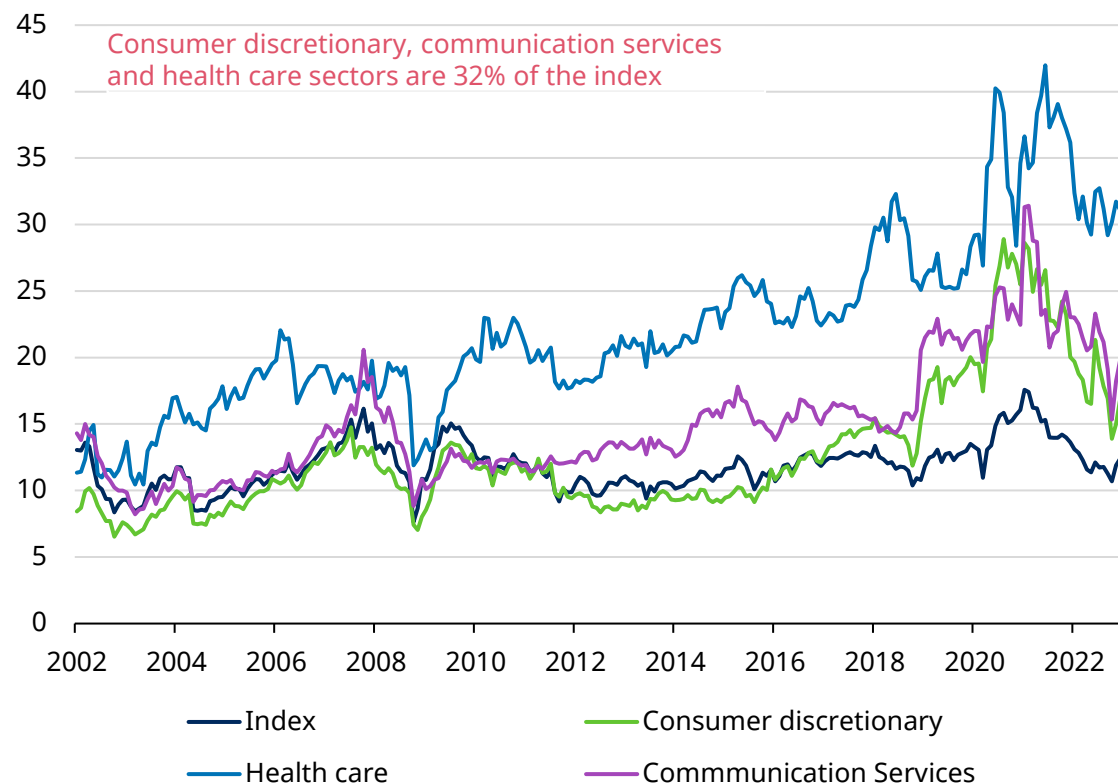
The MSCI EM Latin America Index



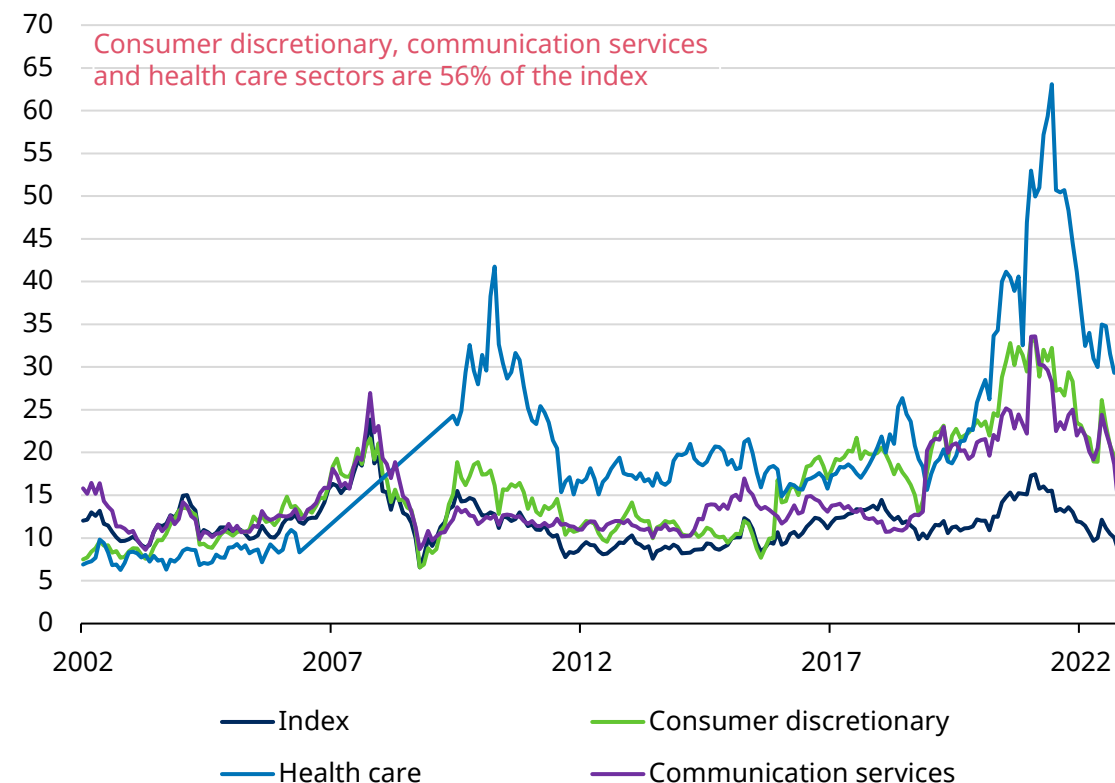
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit, Data as at 31 January 2023. **Value sectors:** energy, materials, industrials, financials, utilities, real estate. **Growth sectors:** consumer discretionary, consumer staples, health care, IT, communication services.

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

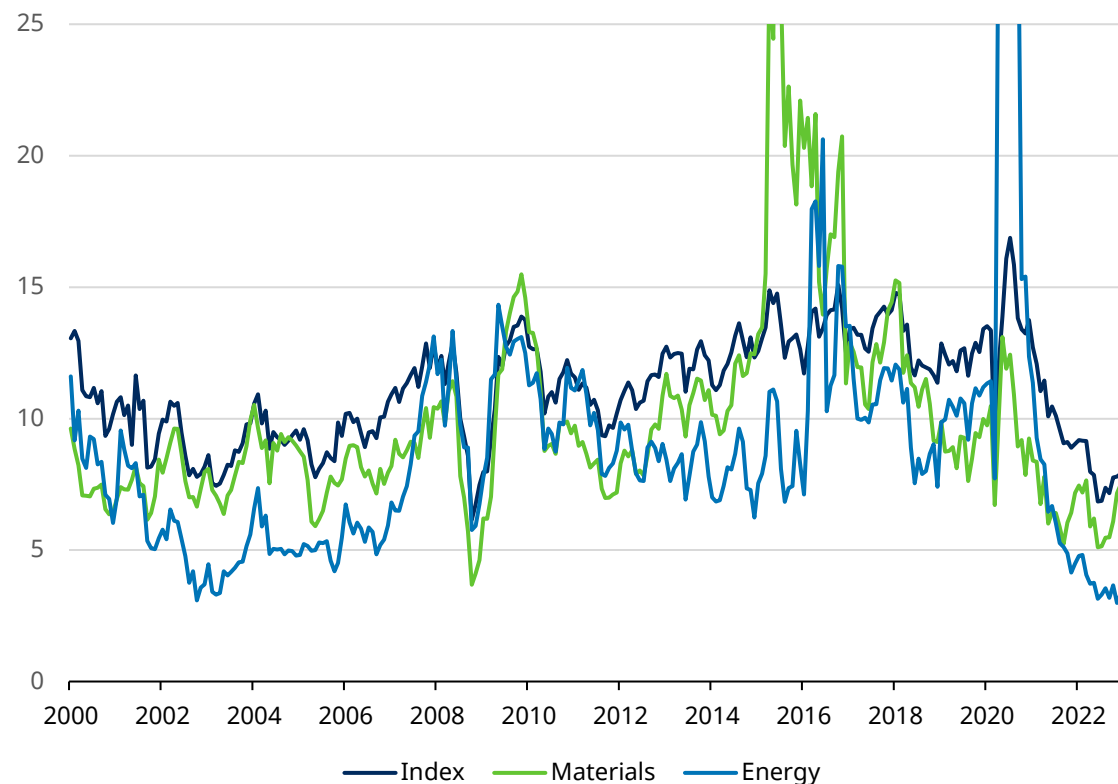


The 2022 falls in high P/E sectors has pushed valuations lower in China + broader EM Asia

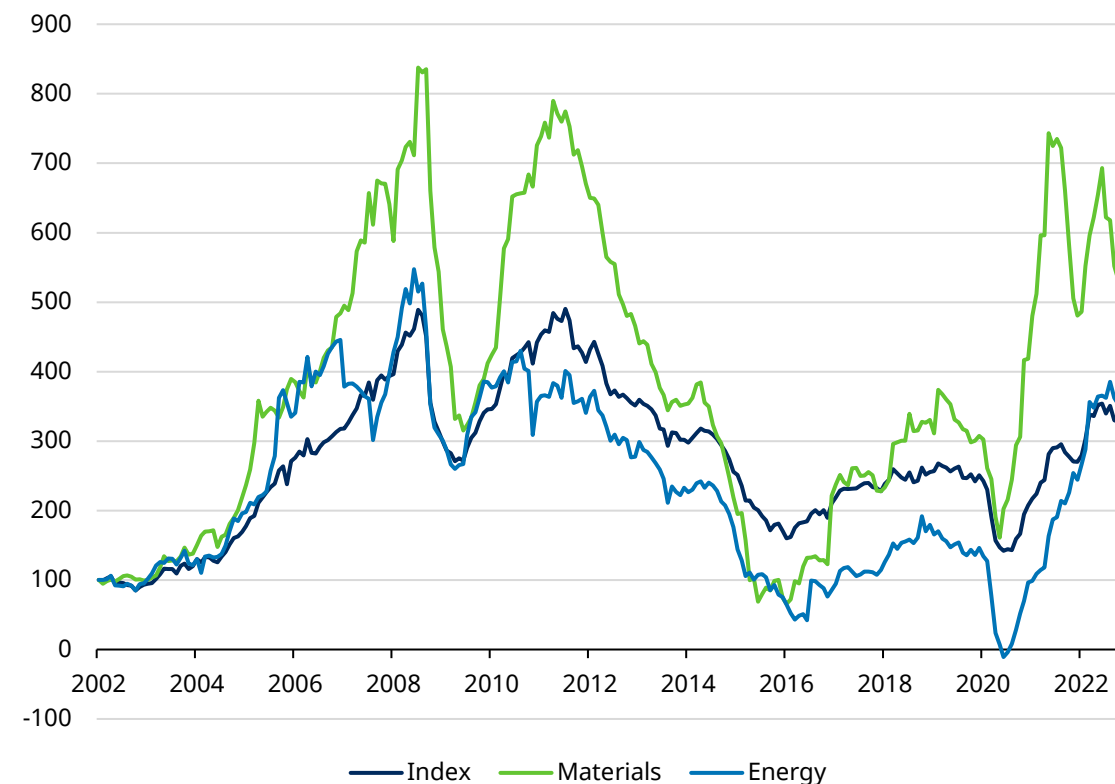
Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 January 2023.

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



Are earnings expectations in the Latin American materials sector bottoming?

Source: Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

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 Philippines are cheap vs history.

Asian market valuations are mixed :

- India is still the most expensive market in the EM index.
- Malaysia is the cheapest market in Asia.
- South Korea, Taiwan and China are slightly cheap versus history.

The Latin American markets offer the most compelling valuations:

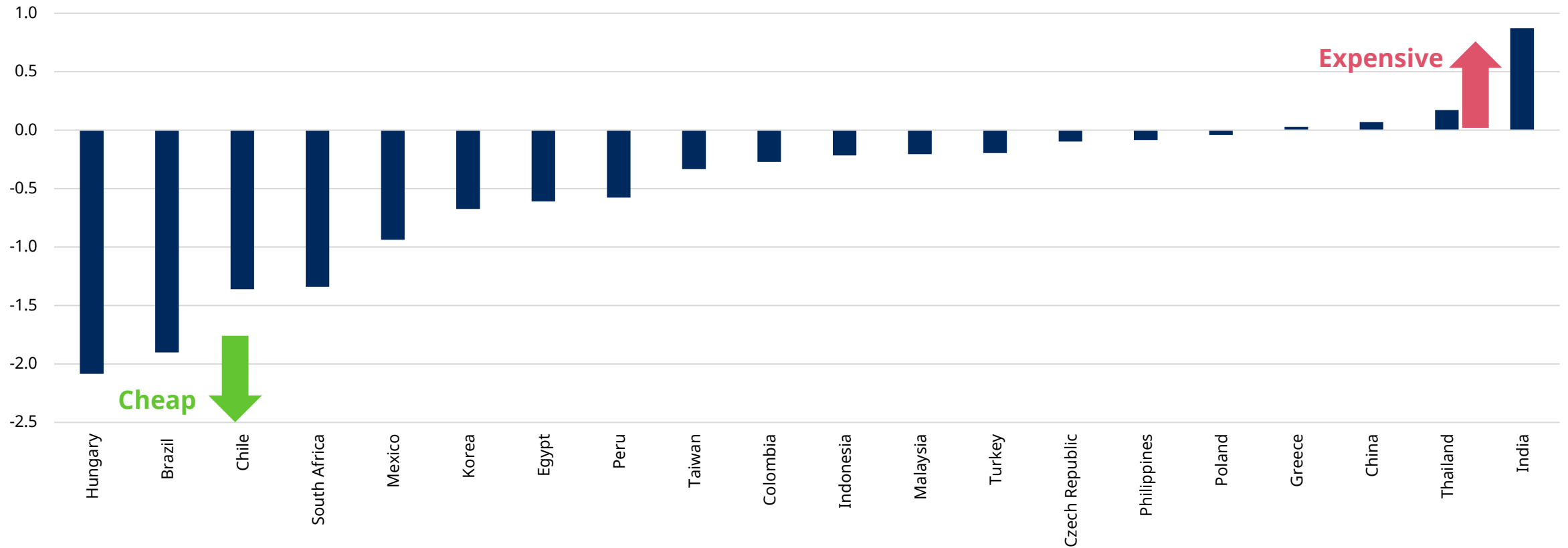
- Chile and Brazil are the cheapest markets in EM, when measured against their own history.
- Mexico, Colombia and Peru are also undervalued relative to their own history.

The EMEA markets are all cheap:

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

Standardised EM country valuations: trailing P/E

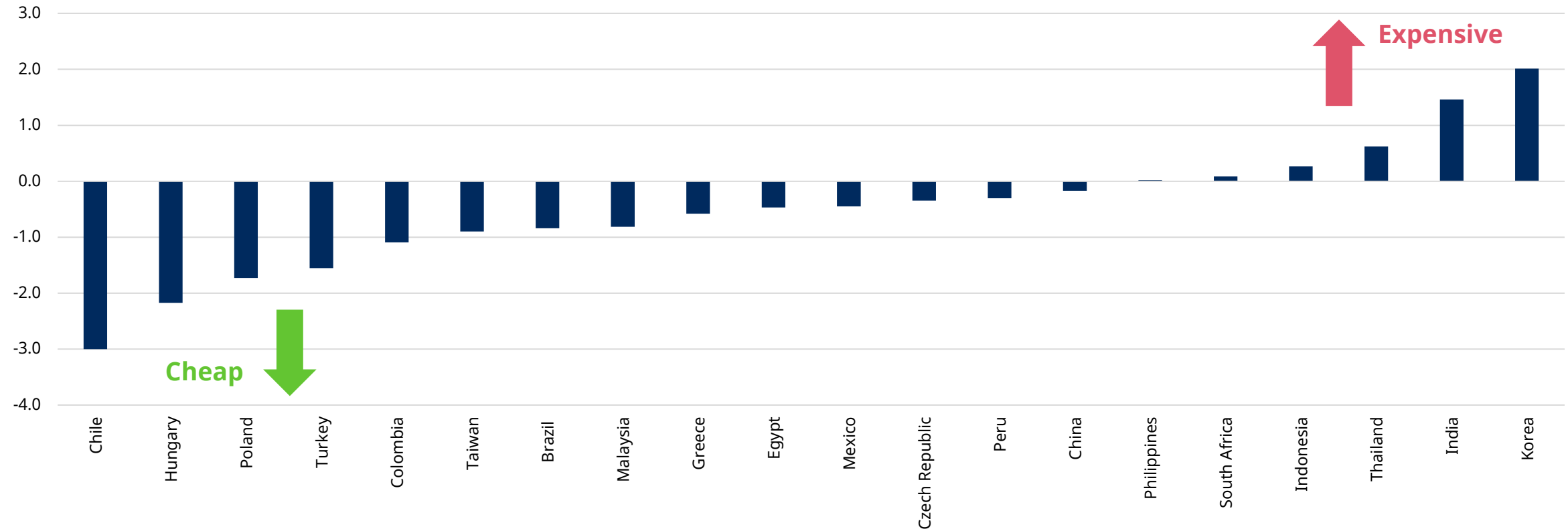
12-month trailing P/E (z-score¹)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. ¹The 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 January 2023.

Standardised EM country valuations: the forward P/E

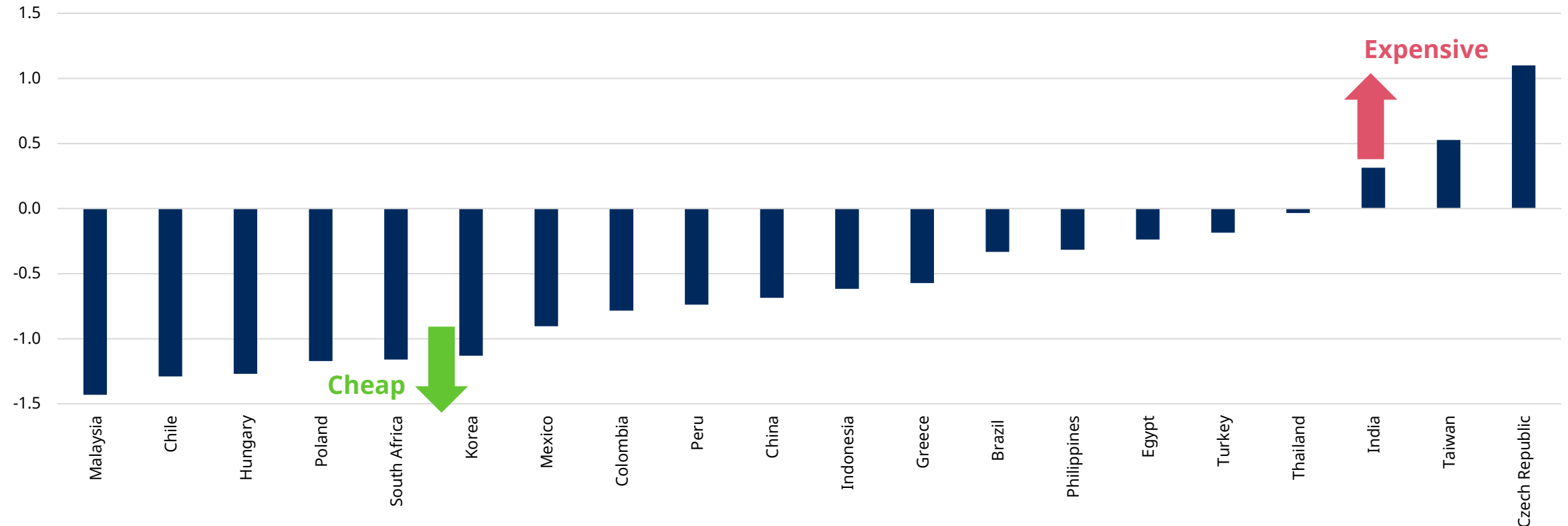
12-month forward P/E (z-score¹)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. ¹The 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 January 2023.

Standardised EM country valuations: the P/B ratio

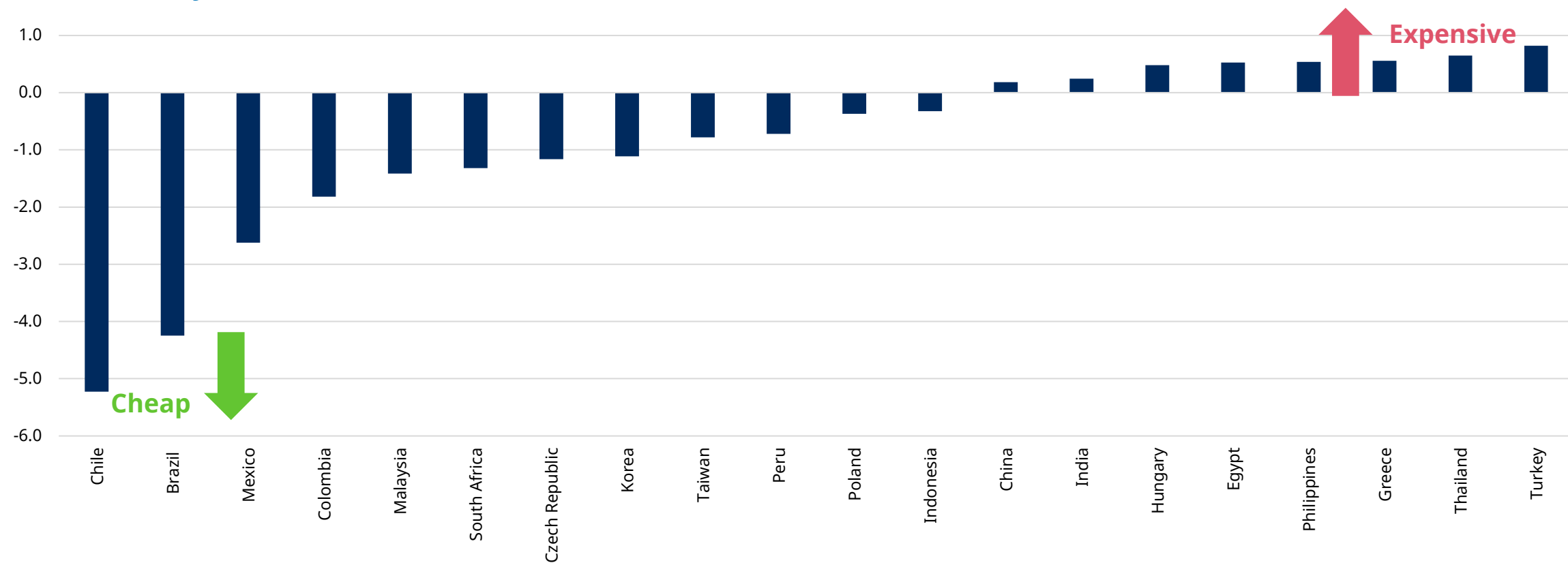
The P/B ratio (z-score ¹)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. ¹The 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 January 2023.

Standardised EM country valuations: the dividend yield

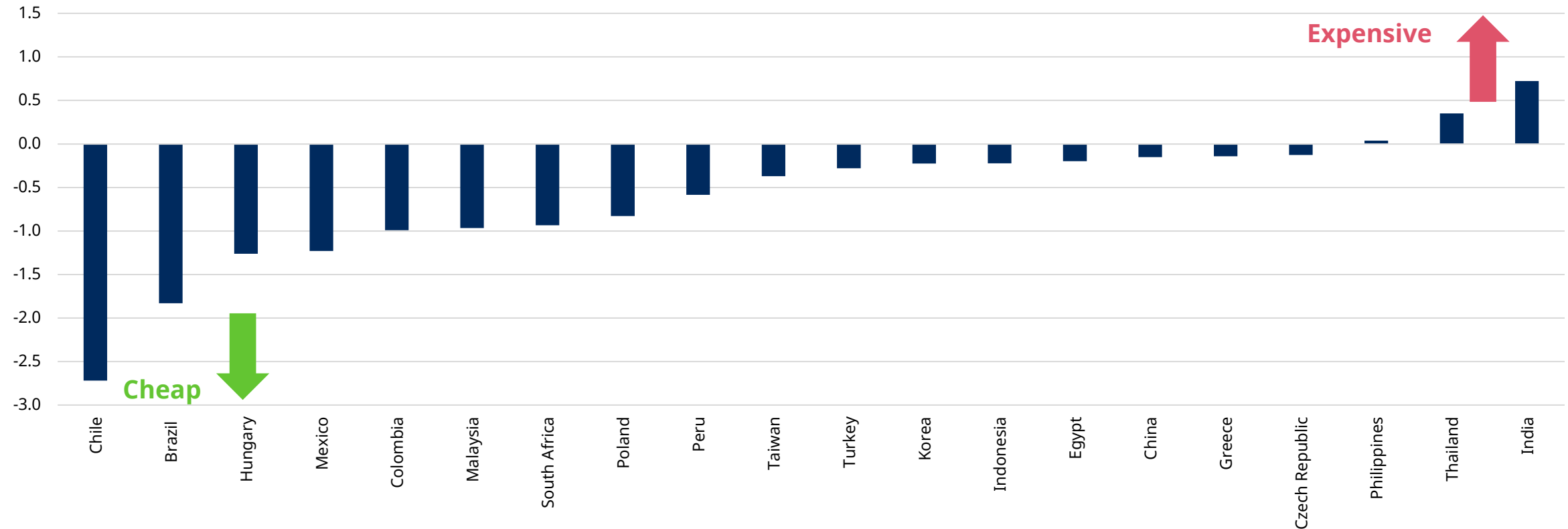
The dividend yield (z-score ¹)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. ¹The 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 January 2023.

Standardised EM country valuations: combined

Average (trailing P/E, P/E, P/B, dividend yield) (z-score ¹)



Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. ¹The 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 January 2023.

EM valuation heatmaps - current z-scores¹

The heatmaps reflect cheapness across most EM – albeit the degree varies

	Trailing P/E	12-month fwd P/E	P/B	Dividend Yield	Combined
Chile	-1.4	-3.0	-1.3	-5.2	-2.7
Brazil	-1.9	-0.8	-0.3	-4.2	-1.8
Hungary	-2.1	-2.2	-1.3	0.5	-1.3
Mexico	-0.9	-0.4	-0.9	-2.6	-1.2
Colombia	-0.3	-1.1	-0.8	-1.8	-1.0
Malaysia	-0.2	-0.8	-1.4	-1.4	-1.0
South Africa	-1.3	0.1	-1.2	-1.3	-0.9
Poland	0.0	-1.7	-1.2	-0.4	-0.8
Peru	-0.6	-0.3	-0.7	-0.7	-0.6
Taiwan	-0.3	-0.9	0.5	-0.8	-0.4
Turkey	-0.2	-1.6	-0.2	0.8	-0.3
Korea	-0.7	2.0	-1.1	-1.1	-0.2
Indonesia	-0.2	0.3	-0.6	-0.3	-0.2
Egypt	-0.6	-0.5	-0.2	0.5	-0.2
China	0.1	-0.2	-0.7	0.2	-0.2
Greece	0.0	-0.6	-0.6	0.6	-0.1
Czech Republic	-0.1	-0.3	1.1	-1.2	-0.1
Philippines	-0.1	0.0	-0.3	0.5	0.0
Thailand	0.2	0.6	0.0	0.6	0.4
India	0.9	1.5	0.3	0.2	0.7

¹The z-score is a measure of how far valuations are from historical mean, calculated since January 2000.

Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history. Combined figure is an average of trailing P/E, 12-month forward P/E, P/B, and dividend yield.

Source: Schroders, Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

EM valuation heatmaps – discount to historical median

The heatmaps reflect cheapness across most EM - albeit the degree varies

	Trailing P/E	12-month fwd P/E	P/B	Dividend Yield	Combined
Chile	-71%	-46%	-27%	-66%	-53%
Colombia	-61%	-44%	-20%	-55%	-45%
Poland	-53%	-33%	-31%	-31%	-37%
Brazil	-56%	-23%	4%	-71%	-37%
Hungary	-65%	-43%	-53%	17%	-36%
Peru	-28%	-7%	-23%	-34%	-23%
South Africa	-29%	-16%	-22%	-24%	-23%
Mexico	-15%	-4%	-13%	-53%	-21%
Malaysia	-4%	-10%	-20%	-25%	-15%
Greece	-24%	-19%	-46%	33%	-14%
Taiwan	-34%	-3%	13%	-29%	-13%
Indonesia	-17%	-3%	-12%	-19%	-13%
Turkey	-49%	-41%	-7%	47%	-12%
Korea	-15%	31%	-20%	-26%	-8%
Philippines	0%	-1%	-11%	3%	-2%
Czech Republic	-36%	-7%	68%	-30%	-1%
Egypt	-21%	-12%	-2%	30%	-1%
China	13%	1%	-12%	5%	2%
India	29%	40%	14%	7%	22%
Thailand	45%	45%	-1%	18%	27%

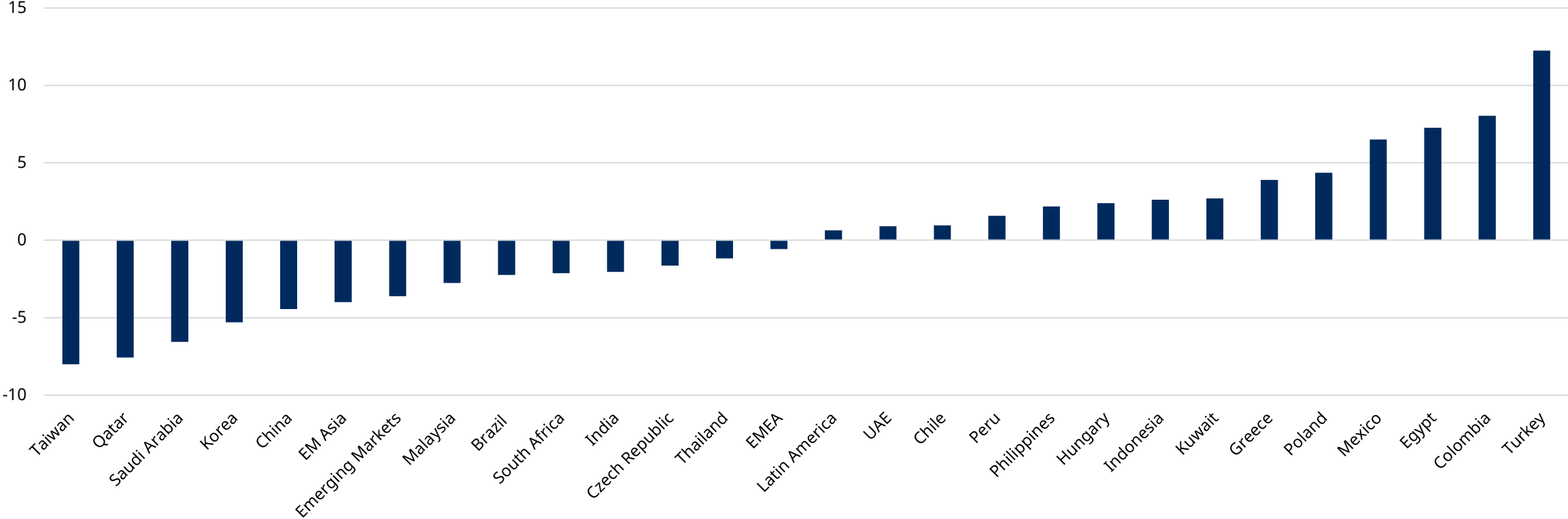
Excludes UAE, Qatar, Saudi Arabia and Kuwait due to limited data history.

Discount to historical median (since Jan 1995 or earliest available). Combined figure is an average of trailing P/E, 12-month forward P/E, P/B, and dividend yield.

Source: Schroders, Refinitiv Datastream, MSCI, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

EM earnings revisions

Earnings revisions¹ (%) (3-month average)

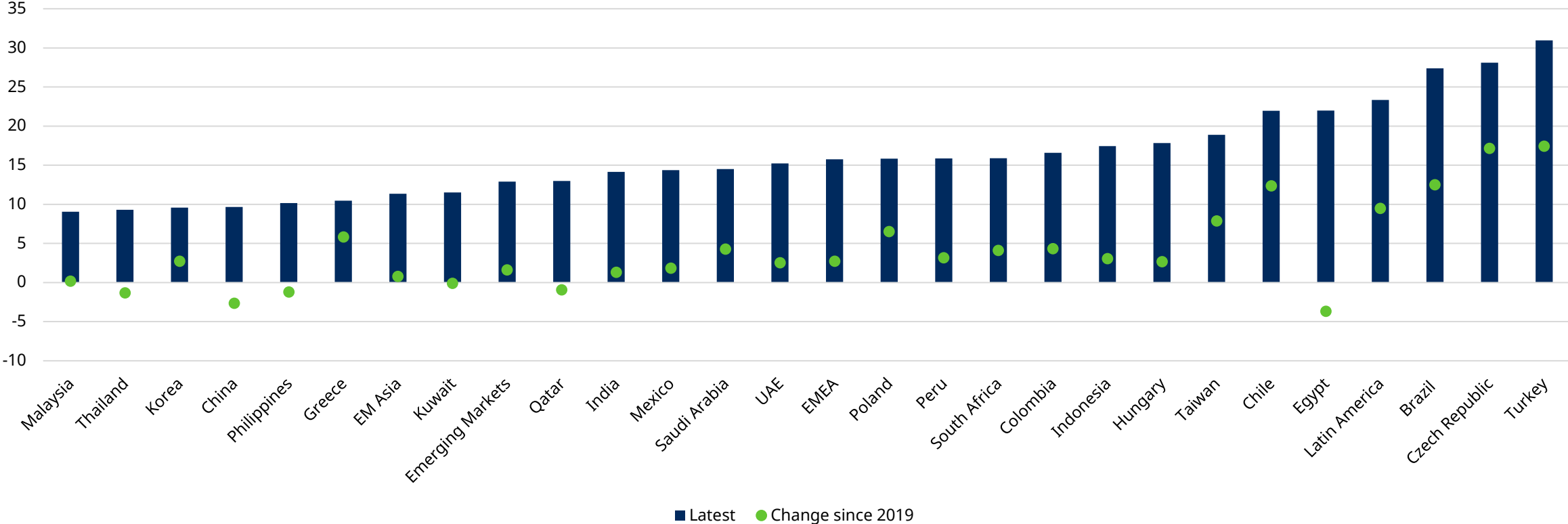


¹Calculated as the number earnings upgrades minus the number of earnings downgrades divided by the total numbers of earnings updates.
 Source: Refinitiv Datastream, IBES, Schroders Strategic Research Unit. Data as at 31 January 2023.

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 January 2023.



EM currency valuations

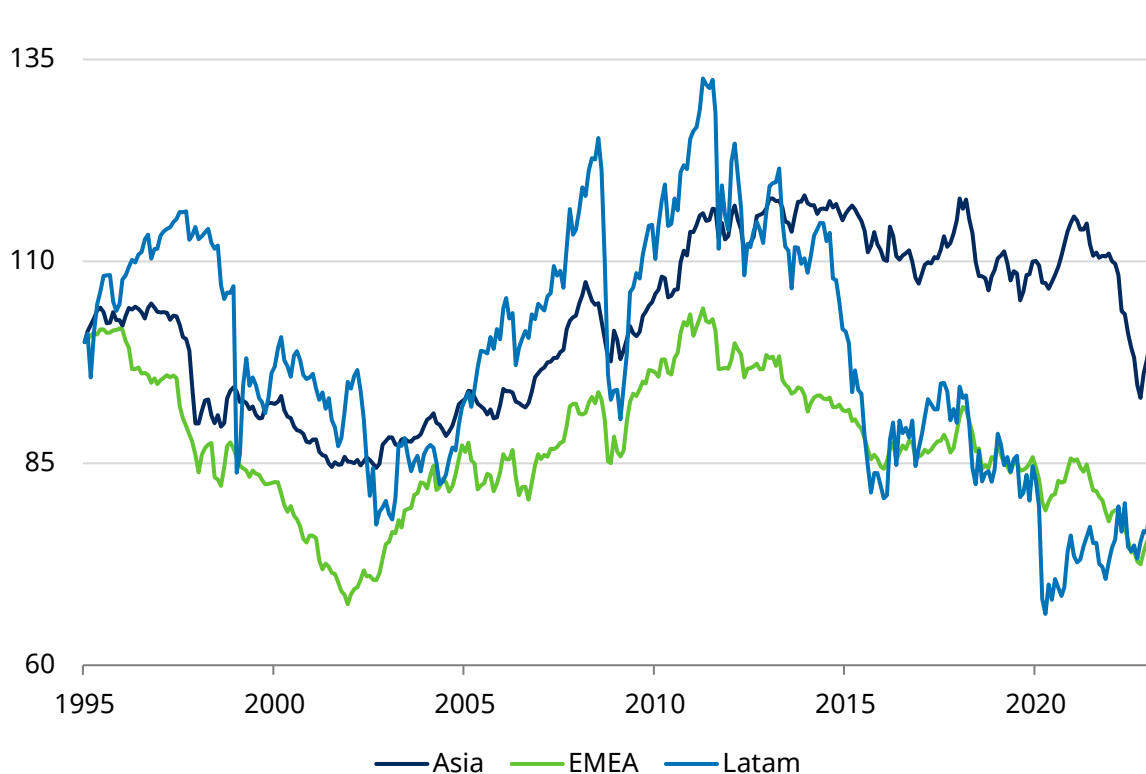
Is there value in EM currencies?

After depreciating in real terms since 2011, EM currencies have appreciated recently

EM real exchange rate¹



EM real exchange rates of regions¹



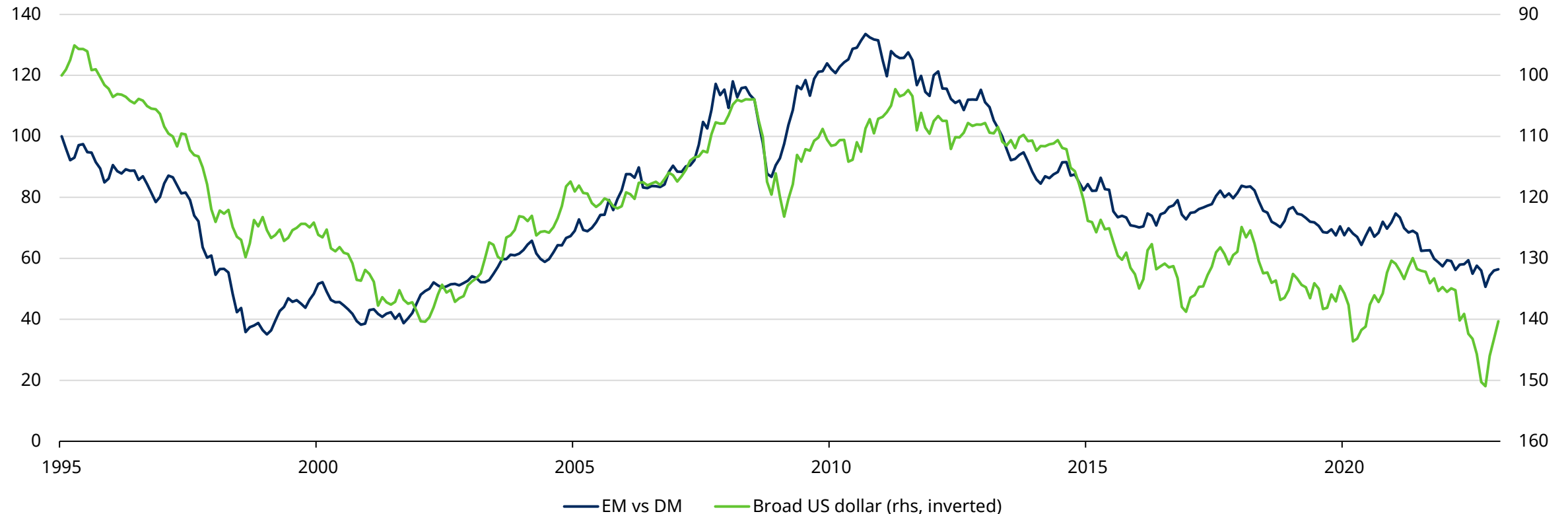
There are significant differences between regions; Latin America and EMEA currencies are cheapest

Real exchange rate is the nominal dollar exchange rate deflated by the CPI of each EM country vs. US. ¹Based on the latest MSCI EM Index country weights. Source: Refinitiv Datastream, MSCI, Schroders Strategic Research Unit. Data as at 31 January 2023.

The importance of the US dollar for EM equity performance

The long period of dollar strength has weighed on EM – but has the tide turned?

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

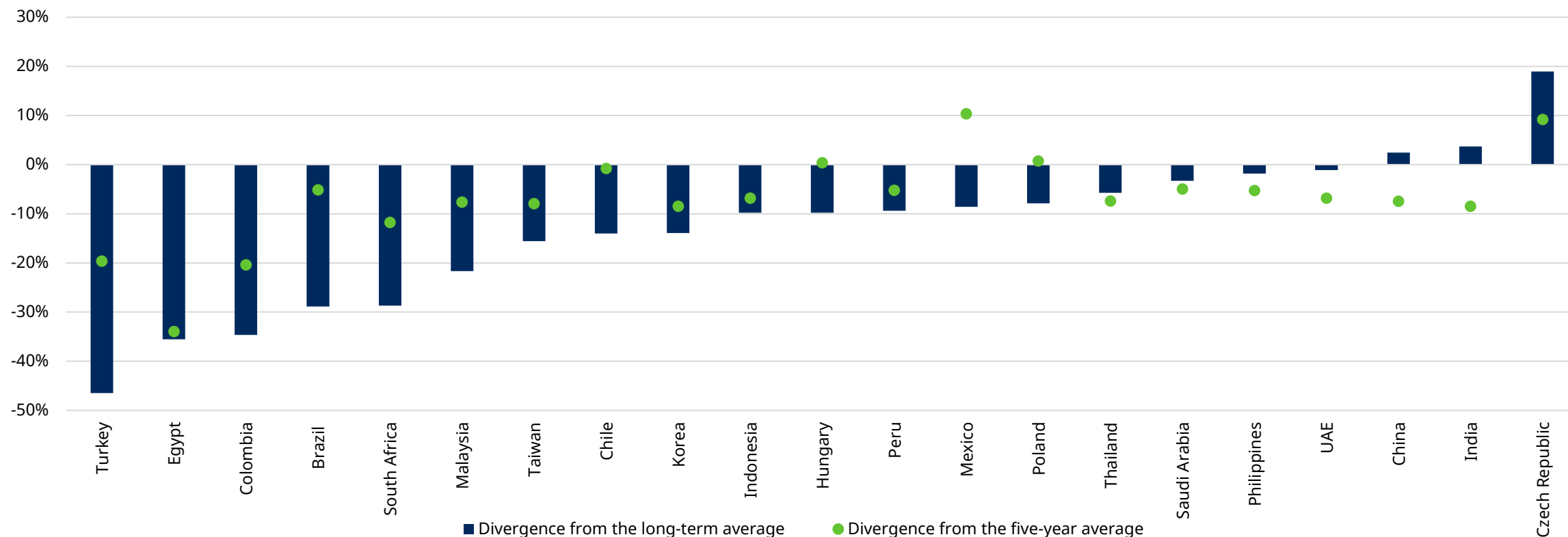


Past performance is not a guide to future performance and may not be repeated.
Source: Refinitiv Datastream, MSCI, Schrodgers Strategic Research Unit. Data as at 31 January 2023.

The value in EM currencies varies considerably

Some currencies are significantly undervalued

Real exchange rate: deviation from average



Turkey, Egypt and Colombia have the cheapest currencies; Czech Republic has a real exchange rate above the long-term and five-year 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 January 2023.

Important information (1 of 4)

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