

Re-emerging markets

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In 1820, today's emerging economies accounted for more than 80% of global GDP. With the onset of the industrial revolution, these inventive and enterprising countries turned inward and ultimately lost their leadership position in the global economy. But in recent times, emerging markets have re-emerged to - from their perspective - regain their rightful place in the economic world. Today, they account for more than 50% of global GDP, up from 38% in 1950.

Numerous factors have contributed to this revival, including these countries' ability to outsource to lower-cost economies in Asia; their acceptance into the World Trade Organisation; strong commodities cycles; their implementation of conservative fiscal and independent monetary policies; price stability and falling interest rates supporting domestic investments and consumption; and favourable demographics. Growth in the working population, a key driver of long-term growth potential, is six times higher than that of developed markets. Plus, poor countries generally grow faster than wealthier ones (GDP per capita in emerging economies averages \$5,000 vs. \$40,000 in developed economies).

While "emerging" implies they are still catching up with western economies, this catching up is happening at breakneck speed. According to PricewaterhouseCoopers, by 2050, China's economy will be nearly equal in size to the US economy. Interestingly, today, non-developed economies account for 85% of the global population, 75% of global land mass and 70% of global foreign exchange reserves, yet for only 8% of global market capitalisation. Despite short-term global equity markets' volatility and correlation, there are reasons to believe that in the medium to long term, emerging markets' capitalisation will rise substantially from their current levels.

The last decade has witnessed an underlying secular improvement in developing economies as reflected in the doubling of the MSCI Emerging Market index (up 90% since 1998), compared to a fall of 35% in the S&P500 Index over the same period. This uptrend has been driven by a combination of fast economic growth and steady improvement in emerging corporate return on equities (emerging companies' return on equities were half those of developed markets a decade ago; today they are approximately the same).

This trend of emerging economies re-emerging is just beginning to gain speed. The emerging markets equity bull market was born at a time of deflation, fear and cheap stocks, and will likely die at a time of inflation, greed and expensive stocks. This bull market is far from over and although all great bull markets end with greed, leverage, narrow leadership and egregious valuations, that's likely still a few years away.