

# Time for a Closer Look at Emerging Market Equities



**F**or investors who can look past the volatility and interpret the confusing signals, today's emerging markets reveal a focused selection of long-term investment opportunities. Unfortunately, the negative or even misleading headlines have led many investors to throw in the towel on emerging market stocks altogether. Yet, emerging market equities currently offer active investors the opportunity to focus on the countries, industries and companies that can continue growing.

Although there are well-founded concerns about rising US interest rates and China's slowing economy, we believe that certain emerging economies and certain companies operating in those markets show the potential to hold up well even in the face of adversity. In addition, from a timing perspective, recent volatility has created an attractive entry point to initiate or expand a position in high-quality emerging market companies. Since the potential for growth appears focused within pockets of opportunity, we believe active security selection is the key to investing in the current emerging markets environment.

## Emerging markets can survive (even thrive) if US interest rates rise

A US interest rate hike is unlikely to spell doom and gloom for all emerging markets. A rising interest rate environment reflects a stronger US economy which could herald greater import demand from the US. This should benefit emerging markets that rely on exporting their goods and services to the US such as Mexico, South Korea, China and India. For example, Mexico, with almost 80% of its exports going to the US<sup>1</sup>, should see a boost as US import demand increases, which in turn, would have positive effects on Mexico's economy.

Not only are emerging market export sectors positioned to withstand a US interest rate increase, emerging markets currencies also exhibit notable resilience. Many of today's emerging markets, particularly those in Asia, are much less vulnerable to rising US interest rates than they were in the past. Since the

<sup>1</sup> US Department of State

**Many emerging Asian countries have implemented economic and financial sector reforms which include reducing their reliance on foreign debt, boosting their dollar reserves and restructuring their banking sectors.**

Asian Financial Crisis of 1997-1998, a key change for emerging market economies is the shift away from fixed, or “pegged”, exchange rates to more flexible exchange rates. Flexible exchange rates are driven by market supply and demand which can help buffer external shocks such as rising US interest rates. Plus, emerging market central banks now have greater flexibility in terms of the policy tools at their disposal.

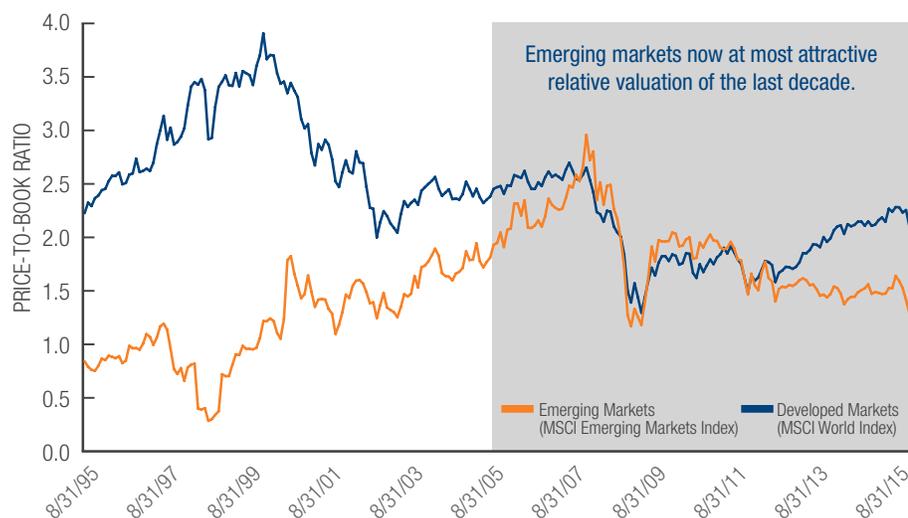
The Asian Financial Crisis taught emerging market countries many lessons. In addition to the move away from fixed currencies, many emerging Asian countries have implemented economic and financial sector reforms which include reducing their reliance on foreign debt, boosting their dollar reserves and restructuring their banking sectors. Despite large declines in recent months, China holds the world’s largest foreign reserves with US\$3.557 trillion<sup>2</sup> as of August 2015. India has also seen a substantial increase in its foreign reserves, with US\$352 billion as of August 2015, up from US\$278 billion two years earlier.<sup>3</sup> Several emerging market countries have also adopted better fiscal discipline which has resulted in healthier fiscal balances today. Unlike the 1990s, today’s major emerging markets have economic defenses in place to help them function better in volatile times.

## Emerging market dispersion enables alpha generation

Emerging markets are not homogeneous. The volatility of the past few months has caused many investors to grow concerned about how a potential slowdown in China may have a ripple effect across the world. However, over the past five years, accommodative US monetary policy has changed the outlook for many emerging market economies, which have further benefited from strategies and reforms enacted by the emerging markets’ central banks. In 2014, the Philippines, as represented by the MSCI Philippines Index, performed extremely well with a return of 25.59% in USD terms, while Brazil declined 14.04% in USD terms, represented by the MSCI Brazil Index.<sup>4</sup> Even within a single country, divergent indicators were visible; while Chinese stocks have generally had a difficult second half in 2015 so far, the Chinese retail sector continued to grow, with retail sales expanding 10.8% year-over-year.<sup>5</sup>

We continue to believe that India is on the cusp of a multi-year bull market. Favorable monetary policy and reforms, including the “Make in India” campaign, are intended to transform India into a global manufacturing hub. The country is also anticipated to be one of the fastest growing economies, with forecasted gross domestic product (GDP) growth of over 7% in 2016.<sup>6</sup>

## PRICE-TO-BOOK RATIO



Source: Bloomberg. Past performance is no guarantee of future results.

## Attractive valuations have created a potentially historic entry point

Valuations remain attractive across emerging market equities, relative to their developed market counterparts. The recent volatility has made emerging markets cheaper than developed markets on the basis of price-to-book ratio, an important metric for valuation. Relative to developed markets, emerging market valuations have not been this attractive in a decade.

The spread between emerging market and developed market valuations signals an opportunity to increase exposure to emerging markets. We believe the current market presents an opportunity to build a position selectively in high-quality companies in the emerging markets at discounted prices. For

strategic, long-term investors who recognize the growth potential of the emerging markets, we believe making an allocation to this asset class may position a portfolio to perform well once global volatility eases and emerging market equities start to recover.

### Volatility and dispersion require active management

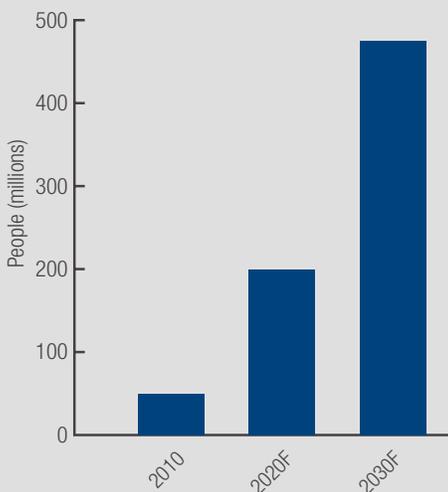
At Mirae Asset, we believe that active management can help uncover attractive investments within the emerging markets. Our emerging markets heritage and local know-how give us insight into the dynamics of emerging market investing at a level that is hard to attain from outside these complex markets.

We apply a fundamentally-driven investment approach and focus on identifying companies with sustainable competitiveness. Our concentrated portfolio approach maximizes exposure to companies that we believe have the most growth potential. We embrace the current environment because we believe that market inefficiency is creating an attractive entry point for actively managed strategies.

## What Matters is Household Income

Rising incomes have contributed to substantial growth of the middle class in the emerging markets. China and India, with their large populations, are likely to experience significant expansion of their middle classes according to research by Ernst & Young. By 2030, around one billion people in China (approximately 70% of its projected population) will be middle class. India's middle class is anticipated to reach 475 million people by 2030, up from 50 million people in 2010.<sup>7</sup>

### INDIA'S MIDDLE CLASS



Source: Ernst & Young.  
Past performance is no guarantee of future results.  
Figures do not reflect forecasted results for any Fund.  
Estimates are only projections and not guarantees.

Related to the expansion of the middle class is meaningful growth in wages. Real wages (i.e., wages adjusted for inflation) have seen stronger increases in emerging markets than in developed markets. While developed markets experienced marginal increases in real wages, emerging markets, such as the Philippines and Indonesia, grew considerably more.

Since household income is a major determinant of spending, a wealthier emerging markets middle class is likely to have a significant impact on consumption supporting both local brands and global franchises. This income trend translates into enormous investment opportunities among companies tapping into economies at different stages of consumption growth and maturity. Consumers' purchasing history in India and Indonesia indicates a preference for reasonably-priced local brands. Consumers in China, on the other hand, have tended to favor globally recognized brands and are moving up the

consumption ladder, spending more on "wants", such as travel and leisure. This growth in consumption by the emerging markets middle class will impact almost every sector and industry globally.

### GLOBAL SALARIES

	COUNTRY	EXPECTED 2015 REAL SALARY INCREASE (%)
Emerging Markets	China	5.7
	Indonesia	4.4
	South Korea	3.5
	Philippines	3.0
	Mexico	1.0
Developed Markets	US	1.0
	UK	0.8
	Japan	-0.8

Source: Hay Group, 2015

**Forecasts suggest India's middle class population will more than double during this decade and more than double again in the next decade.**

<sup>7</sup> Ernst & Young, "Hitting the sweet spot. The growth of the middle class in emerging markets," 2013.

## Global Offices

### Mirae Asset Global Investments

East Tower 26F, Mirae Asset CENTER1 Bldg,  
67, Suha-dong, Jung-gu,  
Seoul, Korea (100-210)  
Tel.+82-2-3774-8200

### Mirae Asset Global Investments (HK)

Level 15, Three Pacific Place, 1 Queen's  
Road East, Hong Kong, HK  
Tel.+852-2295-1500

### Mirae Asset Global Investments (UK)

4-6 Royal Exchange Buildings,  
London, EC3V 3NL, United Kingdom  
Tel. +44-20-7715-9900

### Mirae Asset Global Investments (USA)

1350 Avenue of the Americas,  
33<sup>rd</sup> Floor, New York, NY, 10019, USA  
Tel. +1-212-205-8300

### Mirae Asset Global Investments (Taiwan)

6F, NO. 42, Sec.2 Zhongshan N. Rd.,  
Taipei City 10445, Taiwan (R.O.C)  
Tel. +886-2-7725-7555

### Mirae Asset Global Investments (India)

Unit No. 606, 6th Floor, Windsor Building  
Off. C.S.T Road, Vidyanaigari Marg.  
Kalina, Sanatacruz (East), Mumbai  
400 098, India  
Tel. +91-22-6780-0300

### Mirae Asset Global Investments (Brazil)

Rua Olimpiadas, 194/200,  
12 Andar, CJ 121, Vila Olimpia  
São Paulo, CEP 04551-000, Brazil  
Tel: +55-11-2608-8500

## Definitions and Important Information

Alpha is a measure of risk-adjusted return. Alpha measures the difference between a portfolio's actual returns and what it might be expected to deliver based on its level of risk.

Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Investing in an index is not possible.

MSCI Brazil Index is designed to measure the performance of the large and mid cap segments of the Brazilian market.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI Philippines Index is designed to measure the performance large and mid cap segments of the Philippines market.

MSCI World Index captures large and mid cap representation across 24 Developed Markets countries.

Price-to-Book Ratio (P/B) is the ratio of the share price of a publicly-traded company to its book value per share, which is the company's total asset value less the value of its liabilities.

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