

Sujet: Où sont les meilleures opportunités dans les pays émergents ? / Emerging markets : where are the best opportunities ?

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## Emerging Markets: Identifying The Best Risk-Adjusted Equity Opportunities

A recent report by our Emerging Market Strategy service examines the main factors that explain long-run risk-adjusted performance within emerging market equities.

① Inflation volatility and changes in  $\alpha$  interest rate

② potential growth rates of respective countries are the main determinants of long-run risk adjusted equity performance. Inflation volatility in emerging markets has dropped in the past 10 years, leading to a re-rating in their share prices, especially relative to developed markets. Inflation expectations are now largely stable.

Only major policy errors would be a significant source of higher inflation volatility. The probability of a major policy error can be gauged by looking at the domestic bond and currency markets: In a country susceptible to a major inflationary outbreak, the yield curve should steepen along with currency weakness. On the contrary, when a country is on the brink of a major deflationary shock, the yield curve should flatten while the currency is weak. None of the countries our EM team follows are currently showing symptoms of overheating (yield curve steepening and weak currency) or a pending deflationary bust (curve flattening and weak currency). This does not mean that emerging markets are safe against inflation and deflation, only that based on currency market and yield curve dynamics, an imminent rise in *inflation volatility* seems unlikely. In addition, countries with the highest potential growth rates have the best odds of outperformance and upward surprises are most probable in under-invested countries that are likely to invest. India, Brazil and Indonesia have decent odds of ramping up their potential growth rates which, if realized, should lead to their marked equity outperformance versus their peers.

