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Asian Tigers

Recently, I have written a number of weekly pieces outlining my thoughts as to the emerging markets –those stock markets in the world besides those in Europe, the U.S. and Japan. As highlighted in my earlier pieces, these markets are in economies that have historically higher GDP growth rates than in the developed world. As has been pointed out, these economies should continue to have higher systemic growth rates than those in the more developed world.

When thinking of the emerging economies, many investors lump all emerging economies into a generic grouping. I'm sensing this to be a mistake – as there are countries within the emerging space that will probably continue to grow well above the global average – and those who will struggle going forward. If (or when) the Fed starts to raise interest rates, all emerging markets will more than likely struggle – but, in varying degrees.

Which economies (and markets) may offer investors the higher returns going forward as compared to others? What factors should drive capital towards certain economies and away from others in the coming environment where investable capital may be scarcer?

Higher Returns - Variables

To answer the questions above, we need to study the variables that drive capital to one market and away from others. The variables are numerous. That being said***, understanding which economies may offer higher GDP growth rates (and, consequently, higher corporate profit growth) is helpful in this decision. Additionally, understanding current relative valuation levels also provides good input as to where upside price movement may occur***. While simply examining two variables isn't comprehensive, this view attempts to provide investors a framework from which asset allocation decisions can be roughly judged.

Expected GDP Growth Rates

Not all emerging markets are created the same or, at least, they aren't performing in a generic fashion. According to research supplied by the International Monetary Fund (IMF), ***the Asian tigers (countries in Asia excluding Japan) should show average GDP growth of 6.5% this year and 6.6% next year***. The emerging economies in Europe – led by Russia – are expected to show average economic growth of 2.7% this year and 2.8% in 2015. Lastly, the economies in Latin America are expected to grow at a lethargic rate of 1.3% this year and 2.2% next year.

Remember, a rule of investing is money flows towards growth. Money flows towards where it is treated well. Money doesn't like slow growth or rapidly rising inflation (or deflation). Consequently, I believe money may be better treated in the emerging Asian Tiger countries as compared to emerging Latin America or emerging Europe over the next year. As an

aside, the name "Asian Tigers" comes from the 1990's when investors used this to refer to the mainly economically "free" countries of Hong Kong, Korea, Taiwan and Singapore. I am using the phrase loosely to include other various countries in southeast Asia.

Current Market Valuation Levels

P/E (price to earnings) ratios are not a perfect measure of valuation, but they give us a rough measure as to how investors are currently valuing one country's stock market as compared to others. Following are P/E ratios of various major segments of the world's stock markets (data provided by NDR).

	Current P/E Ratio	Current Dividend Yield
U.S. Stock Market	19.2x	2.0%
Developed European Stock Markets	18.1x	3.2%
Japan's Stock Market	16.1x	1.8%
Pacific Tigers Stock Market	13.3x	3.0%
European Emerging Stock Markets	8.1x	3.6%
Latin America Stock Markets	17.2x	3.5%

An age-old question in stock market investing is what P/E ratio is justified for various investments? One way of viewing P/E (justified) ratios is comparing P/E ratios to growth rates. There should be a positive correlation between P/E ratios and growth rates – the higher the P/E ratio, the higher the growth rate. It is common in investment parlance to calculate P/E to Growth ratios using corporate earnings. In this case, I am comparing current valuation levels to expected economic growth rates in various parts of the world.

Let's take a look at market-wide global P/E ratios as compared to expected GDP growth rates for various areas of the global equity markets (P/E data provided by NDR, GDP data provided by IMF).

	Current P/E Ratio	Expected GDP Growth Rate (G)	P/E to (G) Ratio
U.S. Stock Market	19.2x	3.1%	6.2x
Developed European Stock Markets	18.1x	1.0%	18.1x
Japan's Stock Market	16.1x	0.8%	20.1x
Pacific Tigers Stock Market	13.3x	6.6%	2.0x
European Emerging Stock Markets	8.1x	2.8%	2.9x
Latin America Stock Markets	17.2x	2.2%	7.8x

What this analysis shows is that the emerging markets, by and large, are undervalued by a fairly wide margin to their developed counterparts. Now, this analysis is admiringly simple and shouldn't be used as an absolute guide as to where to invest capital. But, the relative valuation levels are striking.

Additionally, as can be seen from the above, the Pacific Tigers are selling at the lowest valuation level of all global markets, when relative growth is taken into consideration. On an absolute valuation level, the European Emerging stock markets are currently the least expensive.

While the emerging markets tend to be more volatile than the developed markets, perhaps there are some good finds in this reasonably-priced asset class.

We will be back next week.

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IMF -- International Monetary Fund. Retrieved November 16, 2014.

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