INVESTMENT EXECUTIVE
CANADA'S NEWSPAPER FOR FINANCIAL ADVISORS

Emerging markets' value

These markets will become more prominent in global investing

Michael Nairne, Focus on Products

Emerging markets are an increasingly important component of global markets. Consisting in 1988 of 10 countries that comprised only 1% of the world's stock market capitalization, emerging markets have expanded to include 21 countries comprising approximately 12% of the total market cap of the MSCI all-country world index.

Emerging markets, with a combined growth rate more than double that of developed economies, will only become more prominent in global investing. Financial advisors, therefore, need to be aware of the research results recently published in Emerging Markets Review, entitled "Size, Value and Momentum in Emerging Market Stock Returns." This study, covering the period from January 1990 to December 2011, encompassed more than 5,000 stocks from 18 emerging markets grouped into three major regions: Asia, Latin America and Eastern Europe.

The study found strong evidence that the "value effect" exists in each region, as well as in emerging markets overall, while the "momentum effect" also is present (except in Eastern Europe).

The value effect - the tendency of cheaper stocks, as measured by earnings, dividends, cash flow or book value in relation to market value, to outperform more expensive stocks - is a well-researched phenomenon in developed markets.

This is the first study to confirm the existence of both value and momentum across a broad swath of the emerging markets. The study's authors found that the value effect has been materially stronger in the emerging markets than in either the U.S. or global developed markets. Also, the value premium occurred in both large- and small-company stocks within the emerging markets. In contrast, the value premium in the U.S. and global developed markets was stronger in small-company stocks.

The research team at my firm, Tacita Capital Inc., analyzed the returns from January 1997 to July 2013 of the MSCI emerging market value (MEMVI) and growth (MEMGI) indices in Canadian dollars. Our results generally are consistent with the study's findings.

The MEMVI's annualized return of 5.9% was well in excess of the MEMGI's 4.2% return. The value premium in emerging markets was much higher than that in either the U.S. or globally. However, we found that the annualized return of small-company value stocks in emerging markets of 7.7% was higher than the 4.6% return of large-company value stocks.

Advisors looking to implement value strategies in emerging markets should examine low-cost exchange-traded funds (ETFs).

Toronto-based BlackRock Asset Management Canada Ltd.'s iShares Emerging Markets Fundamental Index ETF tracks the FTSE RAFI emerging-market index, which uses total cash dividends, free cash flow, total sales and dividends in its construction. This ETF has a substantial large-cap value tilt.

In the U.S., value strategies focusing on high-dividend-yielding stocks dominate the space. A popular option is WisdomTree Emerging Markets Equity Income Fund, offered by WisdomTree Investments Inc. Its returns since its July 2007 inception have outpaced those of the emerging markets overall.

Michael Nairne, CFP, RFP, CFA, is the president of Tacita Capital Inc., a private family office in Toronto.