

# Challenges and opportunities in emerging market stocks

## Equity Strategy Playbook

December 2021

**Talley Léger**  
Senior Equity Strategist





# Contents

---

## A) Where are we in the market cycle?

1. Market cycles

---

## B) What are the opportunities or challenges?

2. Valuations

---

## C) What are the catalysts?

3. Fiscal policy
4. Monetary policy
5. Economic growth
6. Geographic revenue exposure
7. Earnings growth

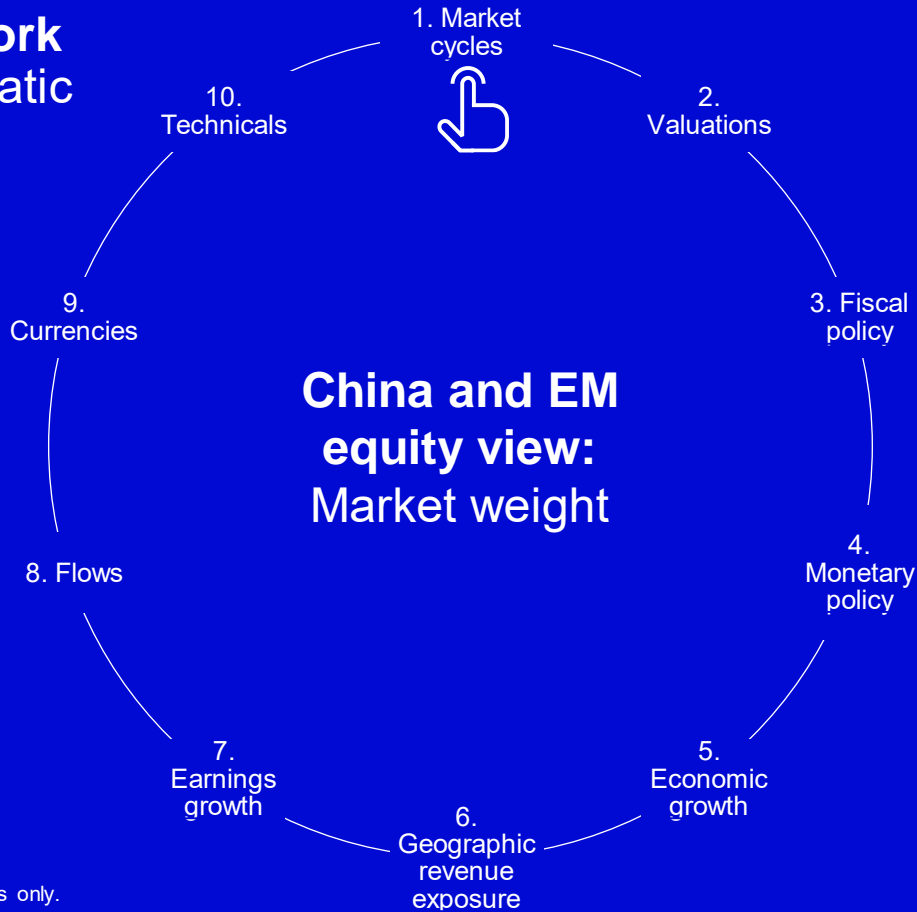
---

## D) How is the herd behaving?

8. Flows
  9. Currencies
  10. Technicals
-

# Multifactor framework

A consistent, systematic method



- A) Cycle: 1
- B) Opportunities or challenges: 2
- C) Catalysts: 3-7
- D) Behavior: 8-10

Source: Invesco. Note: For illustrative purposes only.

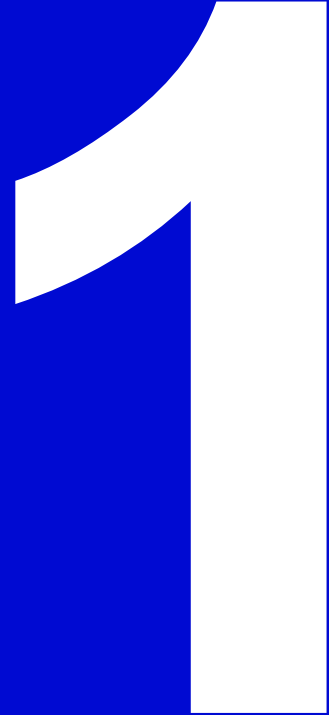


## Market cycles



The trend isn't your friend.

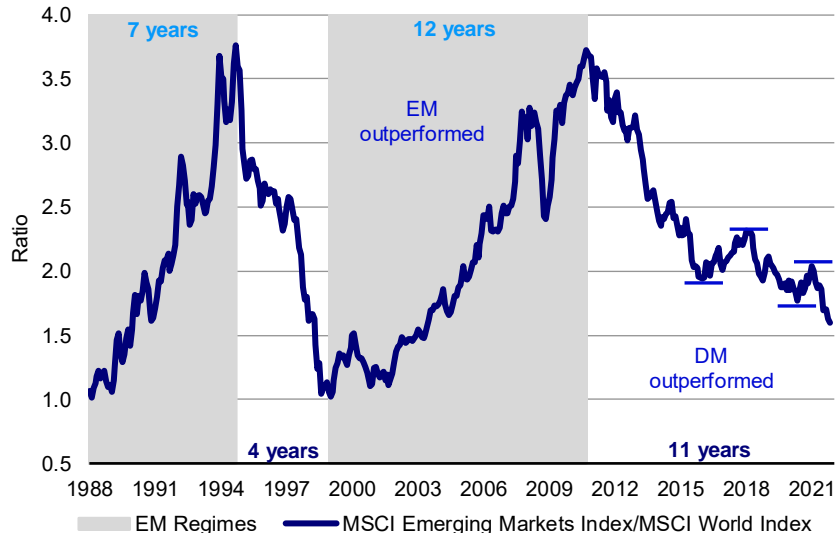
Back



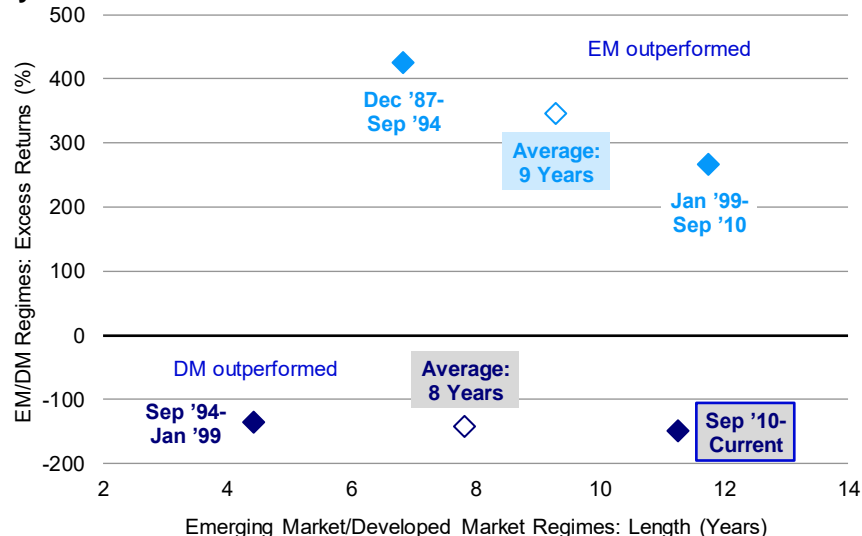
# Market cycles

EM stocks have underperformed for more than 11 years. True, 2016, 2017, and 2020 were banner years, but 2018, 2019, and 2021 were challenging.

Emerging (gray) and developed (white) stock market cycles since 1988



Emerging (light blue) and developed (dark blue) stock market cycles since 1988

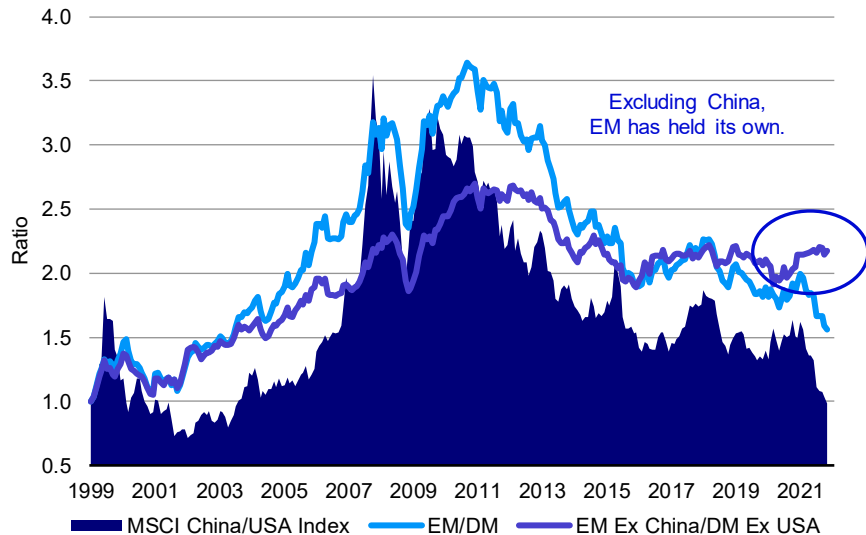


**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World Index price returns in US dollars. An investment cannot be made into an index. **Past performance does not guarantee future results.**

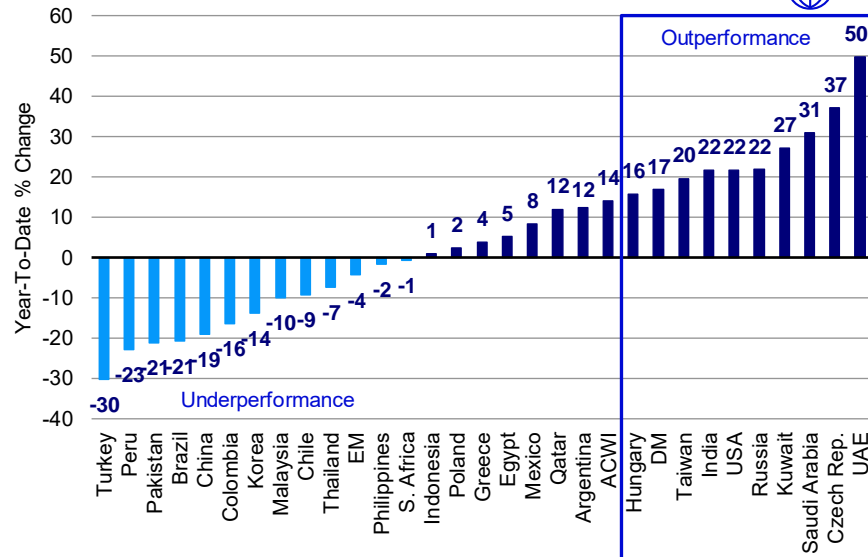
# Market cycles

However, averages can be deceiving, and a closer look reveals some outstanding EM countries. In other words, selectivity is crucial in a difficult environment.

Emerging relative to developed stock market returns since 1999



Emerging and developed stock market returns year to date



**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** EM = Emerging markets. DM = Developed markets = MSCI World Index. UAE = United Arab Emirates. MSCI EM and World Index price returns in US dollars. An investment cannot be made into an index. **Past performance does not guarantee future results.**



## Valuations



Are cheap

Back

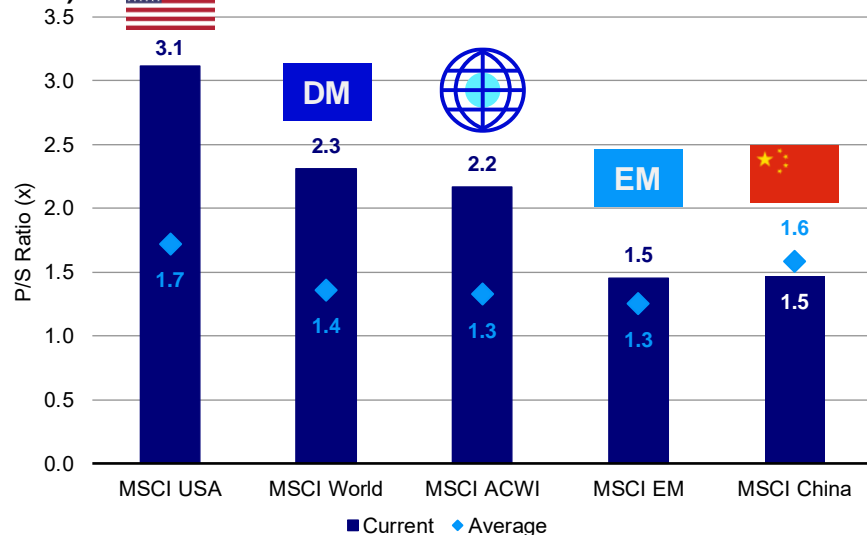


# 2

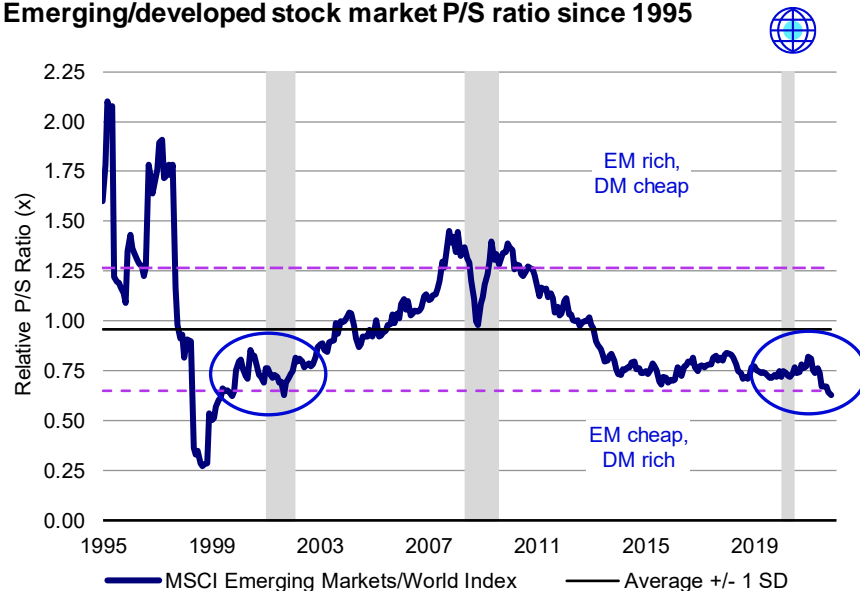
## Valuations – regions

DM stocks have had a long run and are overvalued. By comparison, EM stocks have lagged and offer more attractive valuation opportunities.

Global, regional, and country P/S ratios (current and average since 1995)



Emerging/developed stock market P/S ratio since 1995

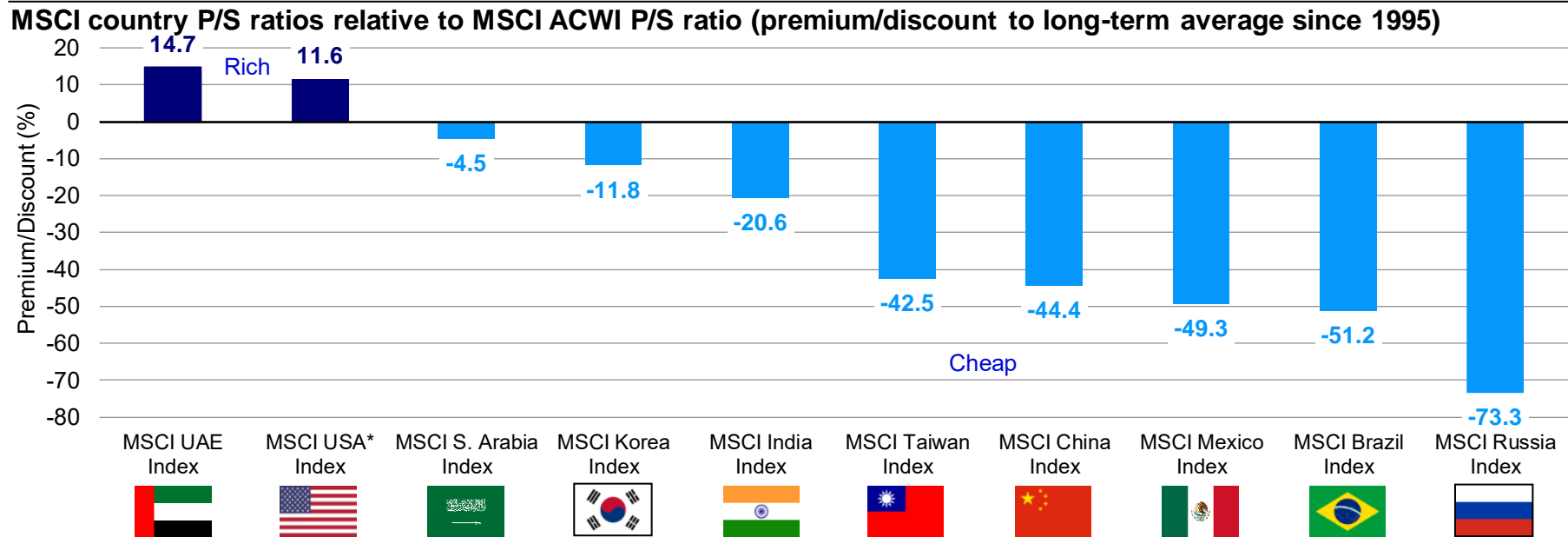


**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** P/S = Price-to-sales ratio. Ranked from left to right—from highest P/S to lowest P/S. ACWI = All Country World Index. Shaded areas denote global all-industry contractions. SD = Standard deviation measures the amount of variation or dispersion around the average of a set of values. An investment cannot be made into an index. **Past performance does not guarantee future results.**



## Valuations – countries

Still, not all EM countries are created equal. Once again, selectivity is key.

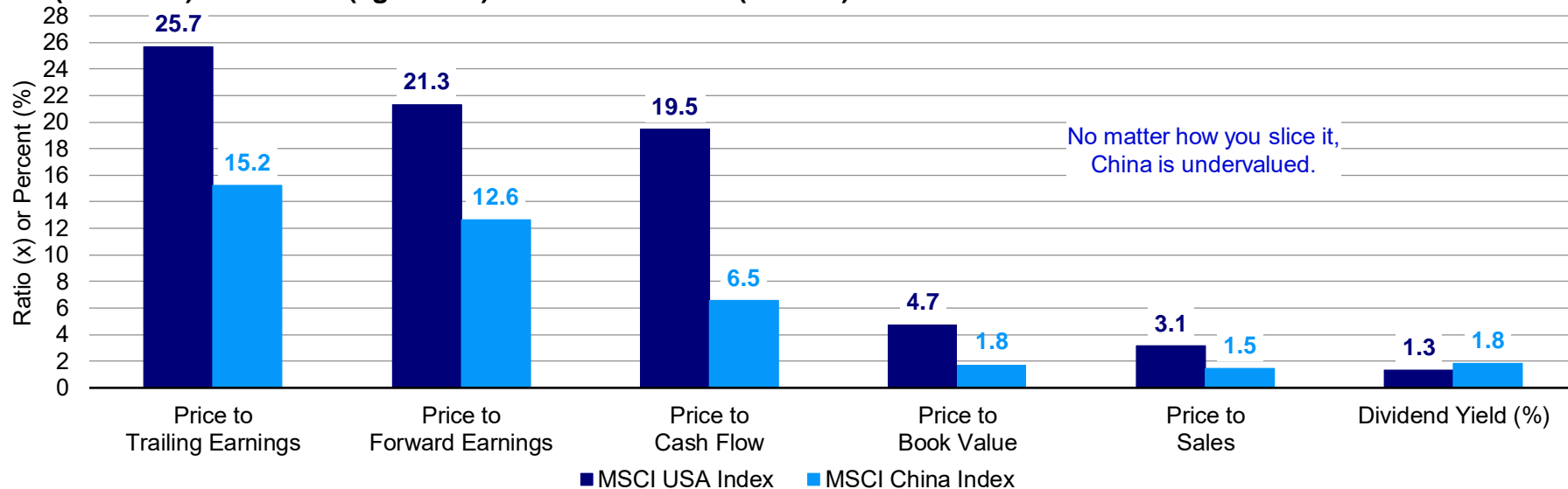


**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** BRICs = Brazil, Russia, India and China. UAE = United Arab Emirates. Ranked from left to right—from biggest premium to biggest discount. \*We included the USA for comparison purposes only. An investment cannot be made into an index. **Past performance does not guarantee future results.**

## Valuations – US and China

China is cheaper than the US across a swath of different valuation metrics.

US (dark blue) and China (light blue) valuation metrics (current)



**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** MSCI USA and China indices ranked from left to right—from highest valuation metric to lowest valuation metric, except dividend yield; a low dividend yield reflects poor value. An investment cannot be made into an index. **Past performance does not guarantee future results.**



## Fiscal policy



Has faded for EM but less quickly than it has for DM

Back

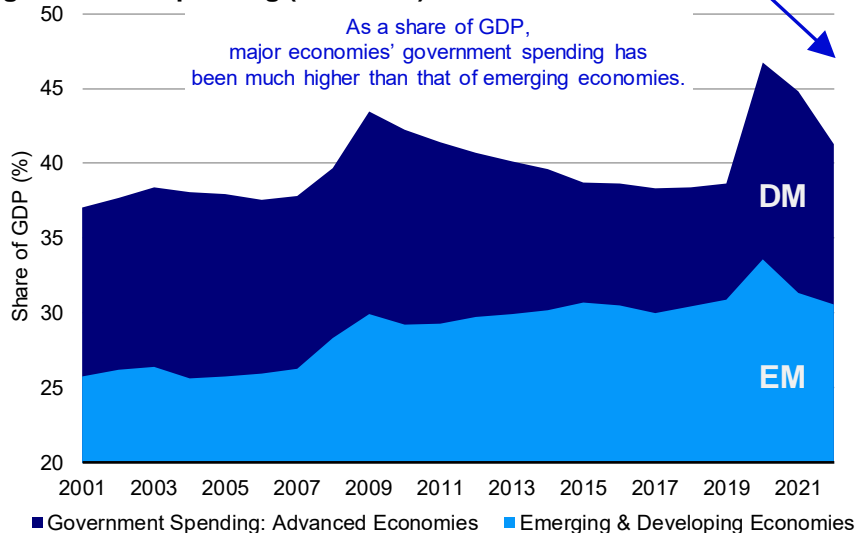


# 3

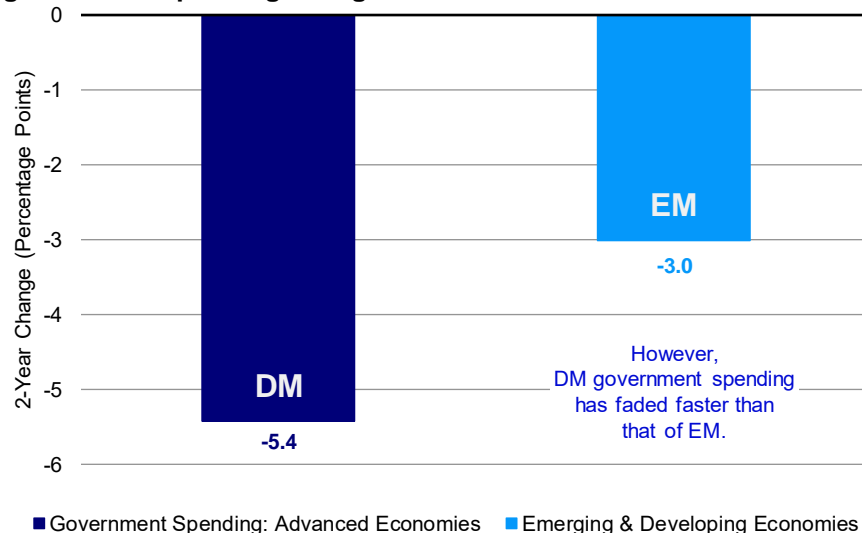
## Fiscal policy – government spending

The fiscal impulse has generally faded but less quickly in the emerging world than it has in the developed world.

Advanced (dark blue) and emerging (light blue) economies' government spending (% of GDP) since 2001



Advanced (dark blue) and emerging (light blue) economies' government spending change since 2020

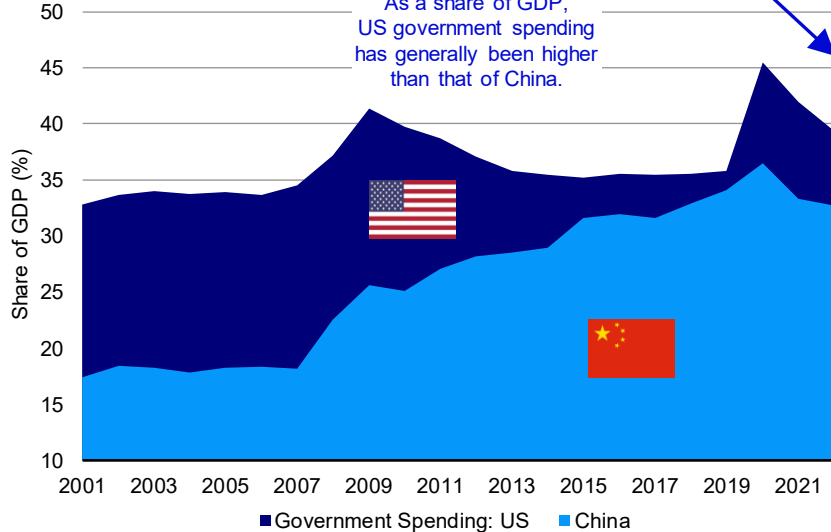


**Sources:** IMF World Economic Outlook database, Invesco, 11/30/21. **Notes:** DM = Developed economies. EM = Emerging economies. General government total expenditure. GDP = Gross domestic product. **Past performance does not guarantee future results.**

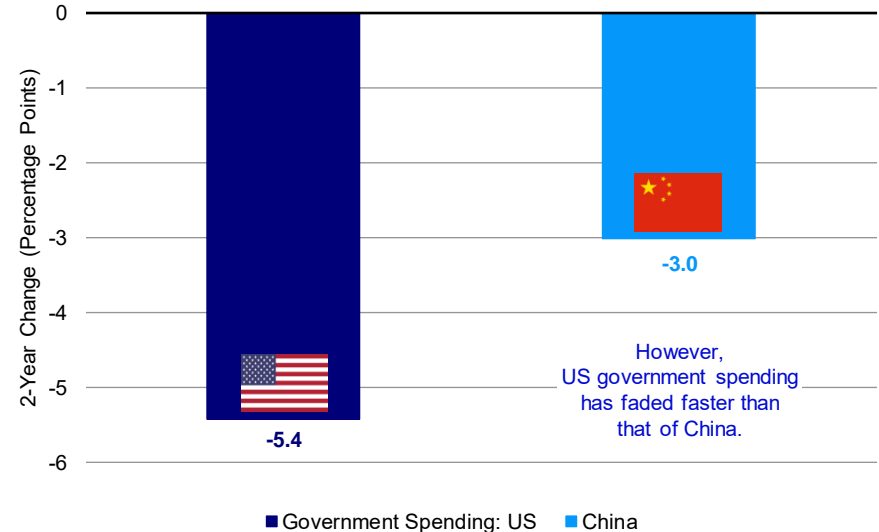
# Fiscal policy – government spending – US and China

Similarly, the fiscal impulse has faded faster in the US than it has in China.

US (dark blue) and China (light blue) government spending (% of GDP) since 2001



US (dark blue) and China (light blue) government spending change since 2020



Sources: IMF World Economic Outlook database, Invesco, 11/30/21. Notes: General government total expenditure. Past performance does not guarantee future results.



## Monetary policy



Has been restrictive but may become less so

Back



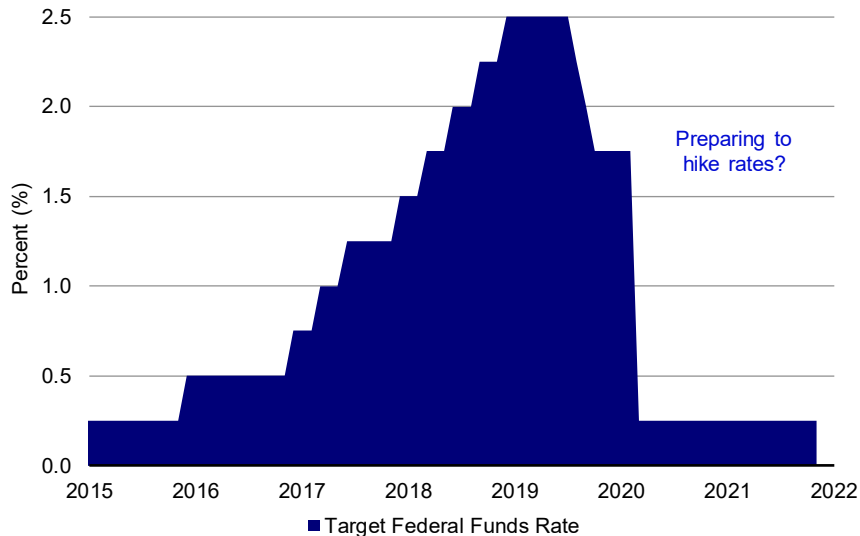
# 4



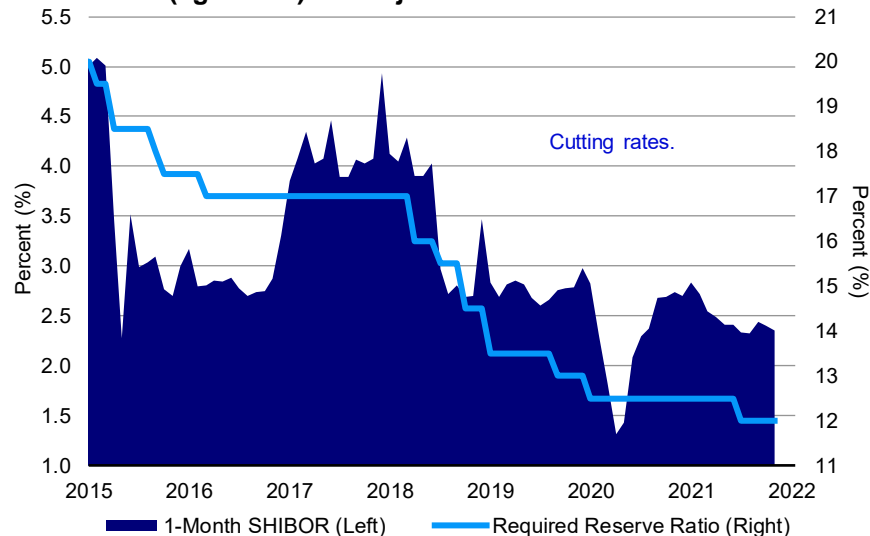
# Monetary policy – interest rates

The US has stepped up its tapering schedule, while China has eased to stabilize growth.

### US short-term interest rate since 2015



### China short-term interest rate (dark blue) and required deposit reserve ratio (light blue) for major banks since 2015

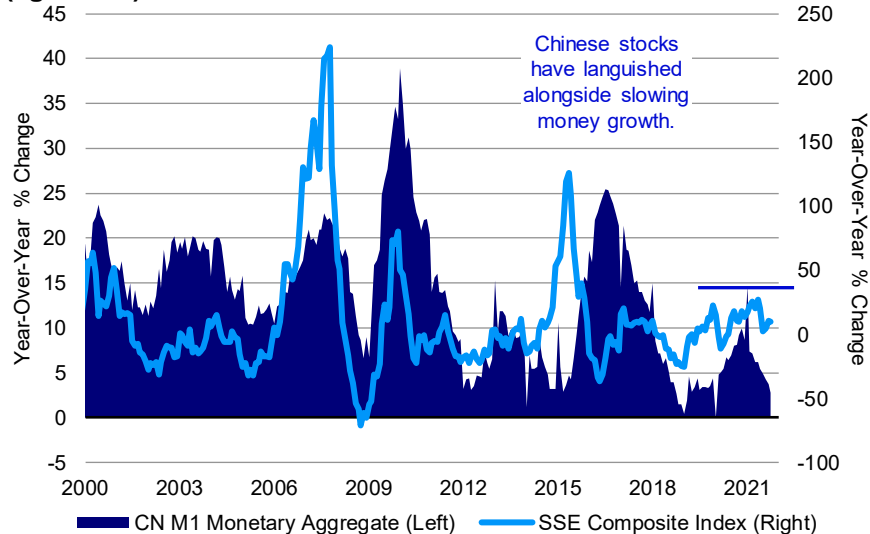


Sources: Bloomberg L.P., FRED, Invesco, 11/30/21. Notes: SHIBOR = Shanghai Interbank Offered Rate. Past performance does not guarantee future results.

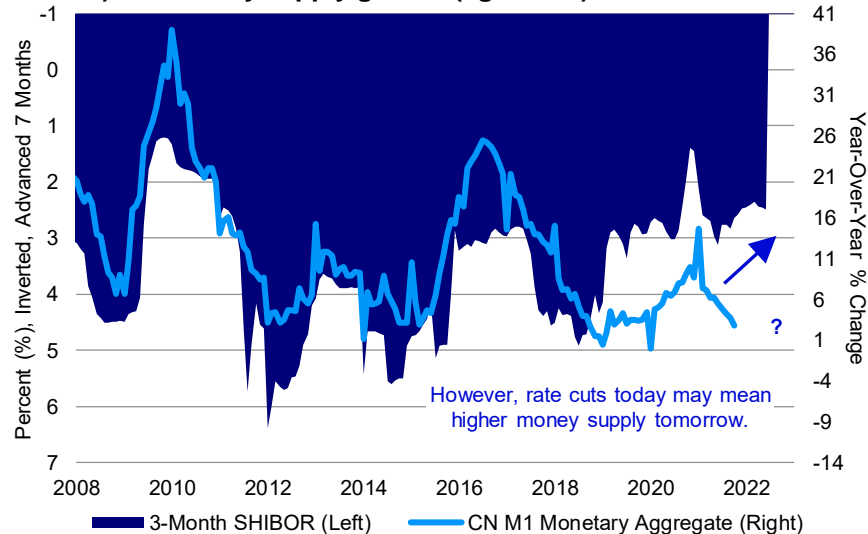
## Monetary policy – money supply

Beijing's easier policy stance suggests a rising tide of money could lift Chinese and EM stocks further down the road.

China money supply growth (dark blue) and stock market returns (light blue) since 2000



China institutional interest rate (dark blue, reversed, pushed forward) and money supply growth (light blue) since 2008



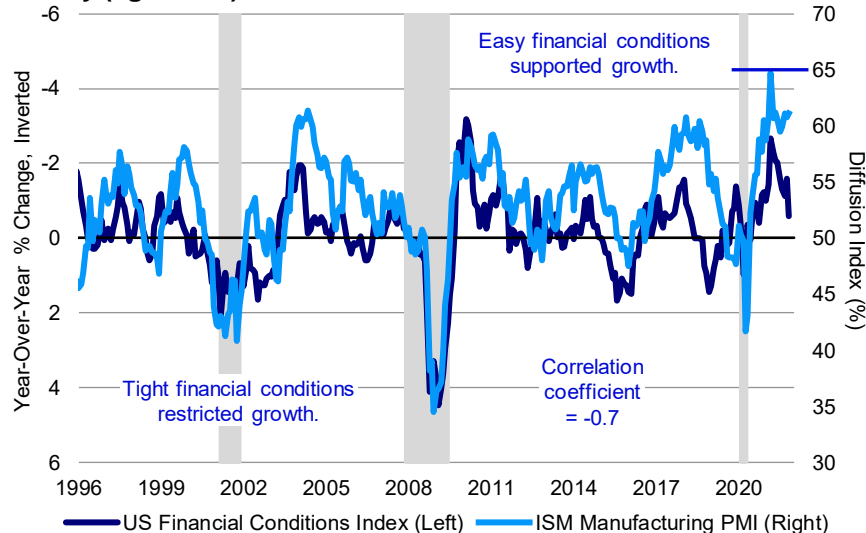
**Sources:** Bloomberg L.P., Macrobond, People's Bank of China, Invesco, 11/30/21. **Notes:** CN = China. SSE = Shanghai Stock Exchange. SHIBOR = Shanghai Interbank Offered Rate. M1 and SSE Composite Index in yuan. An investment cannot be made in an index. **Past performance does not guarantee future results.**



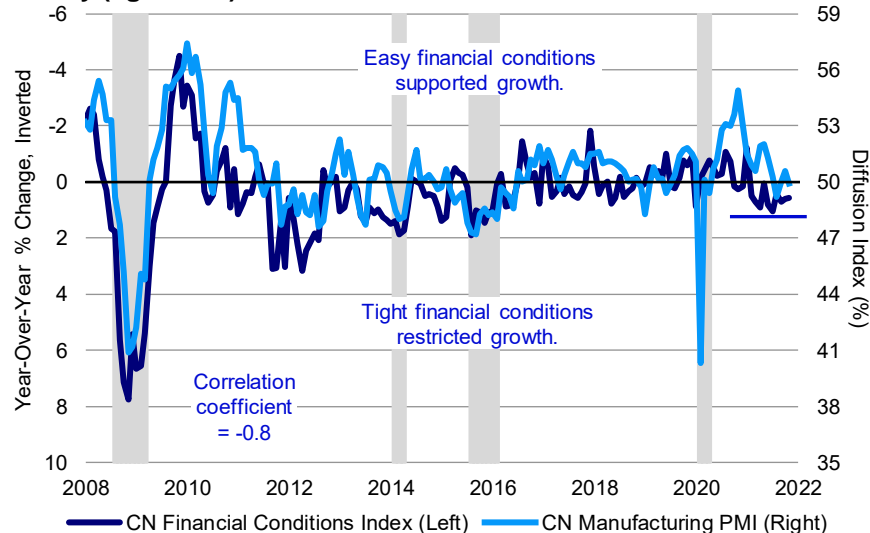
## Monetary policy – financial conditions

Chinese financial conditions have tightened, but sequential improvement could eventually provide a tailwind for emerging economies.

US financial conditions (dark blue, reversed) and manufacturing activity (light blue) since 1996



China financial conditions (dark blue, reversed) and manufacturing activity (light blue) since 2009



**Sources:** Bloomberg L.P., Goldman Sachs, Macrobond, Invesco, 11/30/21. **Notes:** The US Financial Conditions Index includes the federal funds rate, 10-year Treasury bond yield, BBB corporate bond spread, S&P 500 and US dollar. PMI = Purchasing Managers Index. Shaded areas in the left chart denote NBER-defined US recessions. CN = China. Shaded areas in the right chart denote China all-industry contractions. An investment cannot be made in an index. **Past performance does not guarantee future results.**



## Economic growth



Has slowed for EM, but  
global growth remains robust

Back

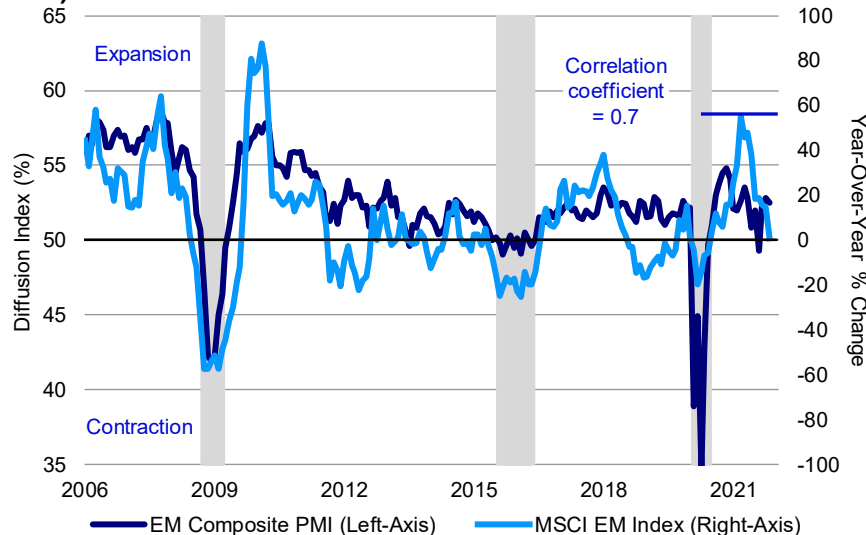


# 5

# Economic growth – absolute

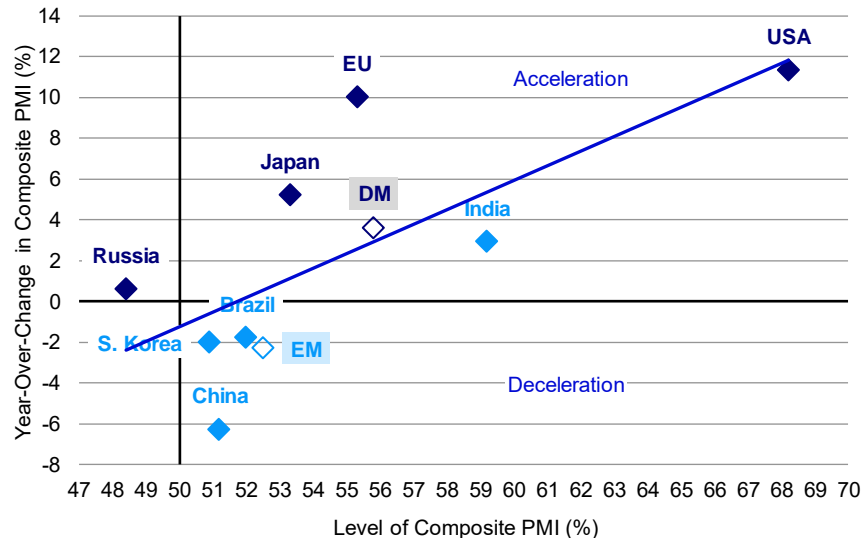
## EM activity has grown, albeit at a slower pace than DM.

EM business activity (dark blue) and EM stock market returns (light blue) since 2006



EM

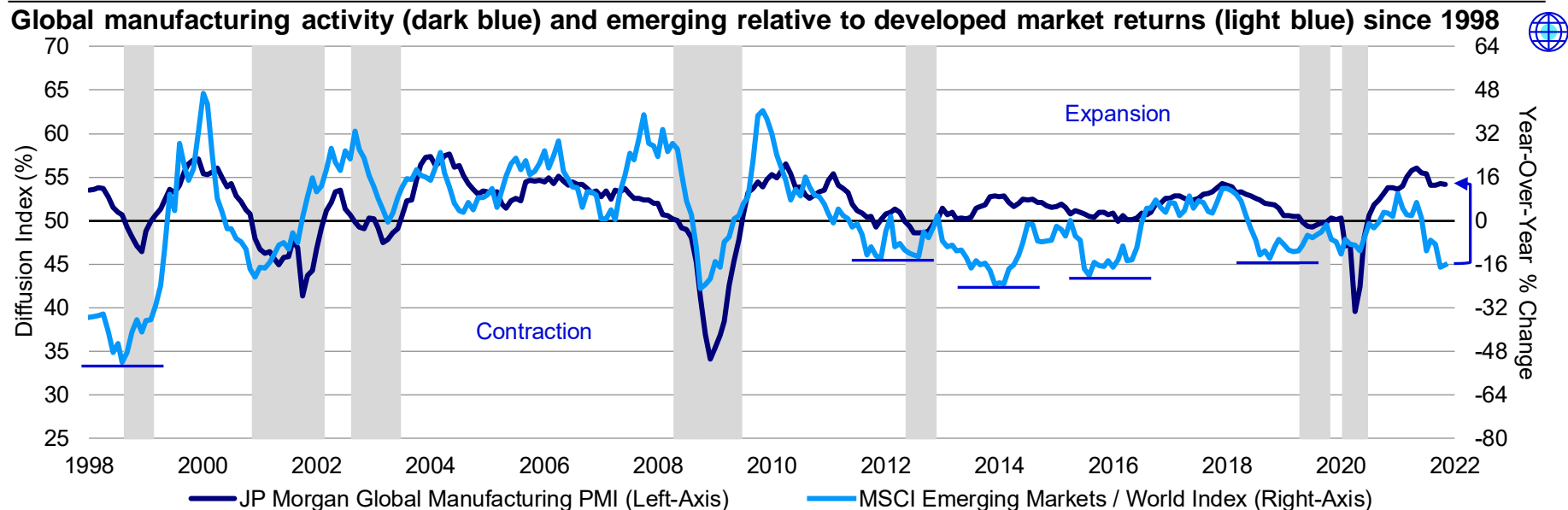
Global business cycle clock (current)



**Sources:** Bloomberg L.P., Macrobond, Invesco, 11/30/21. **Notes:** Composite = manufacturing + services. MSCI EM Index price returns in US dollars. Shaded areas denote EM all-industry contractions. South Korea is displayed with a manufacturing PMI as a services PMI doesn't exist for that cyclical economy. An investment cannot be made into an index. **Past performance does not guarantee future results.**

## Economic growth – relative

EM stocks usually outperformed DM stocks when the global economy was growing. However, EM stocks have overreacted and may be due for a catchup phase.

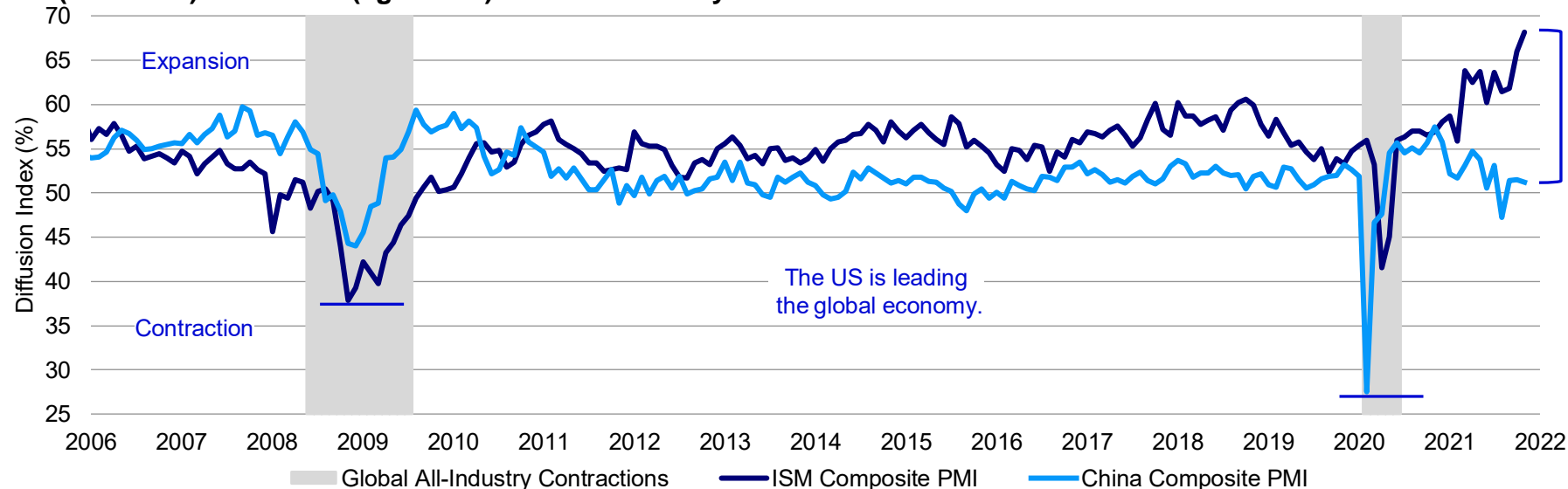


**Sources:** Bloomberg L.P., Macrobond, Invesco, 11/30/21. **Notes:** EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World price indices in US dollars. Shaded areas denote global manufacturing contractions. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

## Economic growth – US and China

Chinese policy tightening in early 2021 and the slowdown it engendered challenged EM stocks. But an attractive entry point may be approaching for patient investors.

US (dark blue) and China (light blue) business activity since 2006

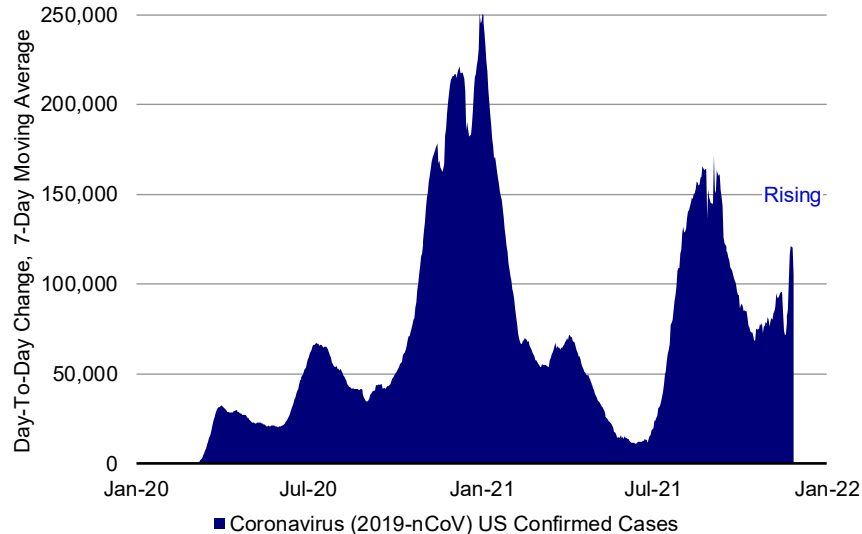


**Sources:** Caixin/IHS Markit, Macrobond, Invesco, 11/30/21. **Notes:** Composite = Manufacturing + services. ISM = Institute for Supply Management. PMI = Purchasing managers index. Diffusion indices have the properties of leading indicators and are convenient summary measures showing the prevailing direction and scope of change. Shaded areas denote global all-industry contractions. See page 36 for index definitions.

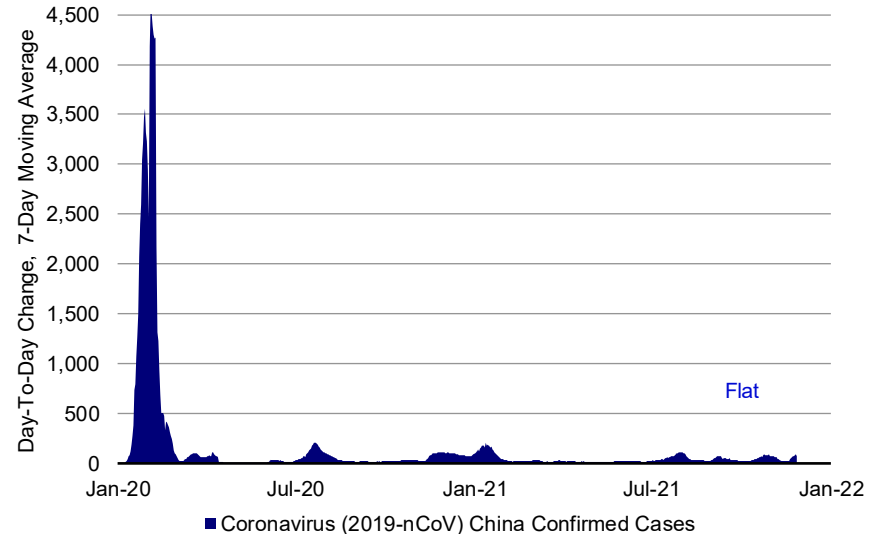
# Economic growth – coronavirus – US and China

China has flattened its case curve, but that hasn't helped EM stocks.

US coronavirus cases (daily change, smoothed) since 2020



China coronavirus cases (daily change, smoothed) since 2020



**Sources:** Bloomberg L.P., Invesco, 12/7/21. **Notes:** Left chart capped at 250,000. Right chart capped at 4,500. Confirmed coronavirus (2019-nCoV) case counts compiled by Bloomberg Newsroom. Counts are subject to change as governments survey and confirm cases. Data are based on reported values as of midnight EST.



## Geographic revenue exposure



Chinese imports and raw industrial commodities have been strong

Back

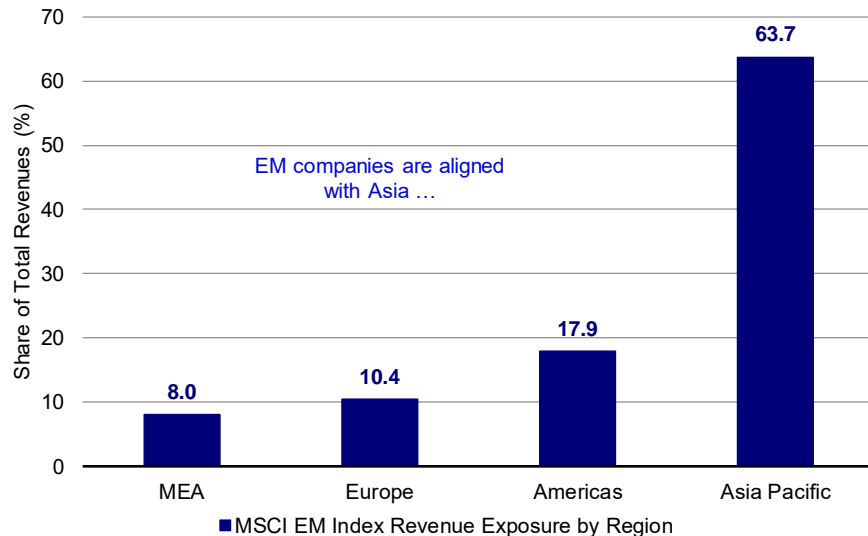


# 6

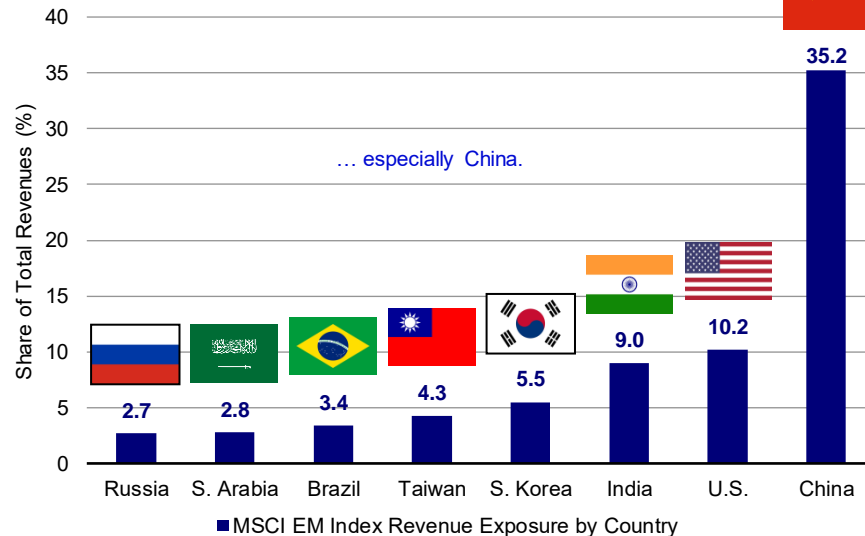
## Geographic revenue exposure – China

China is currently the biggest demand base for EM companies, not the US.

EM companies' revenue shares by region (% of total revenues)



EM companies' revenue shares by country (% of total revenues)



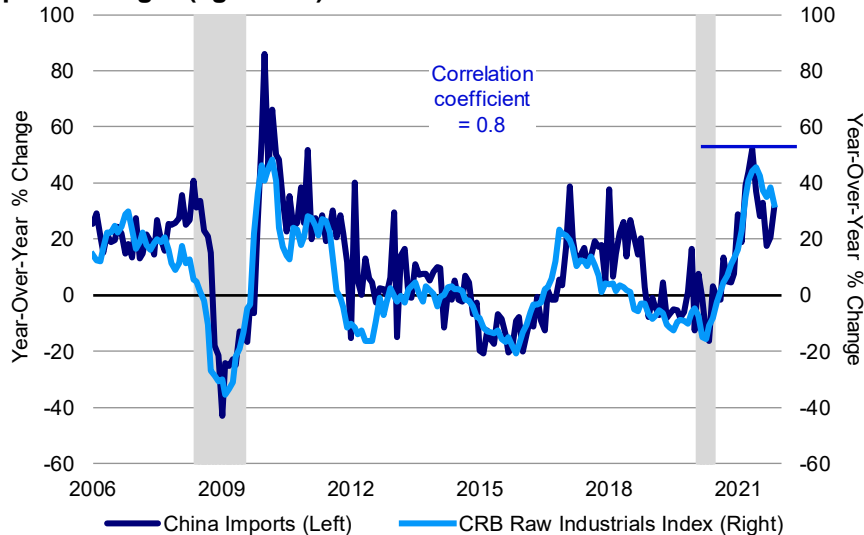
Sources: FactSet, Invesco, 11/30/21. Notes: MEA = Middle East and Africa. ID = Indonesia. Past performance does not guarantee future results.



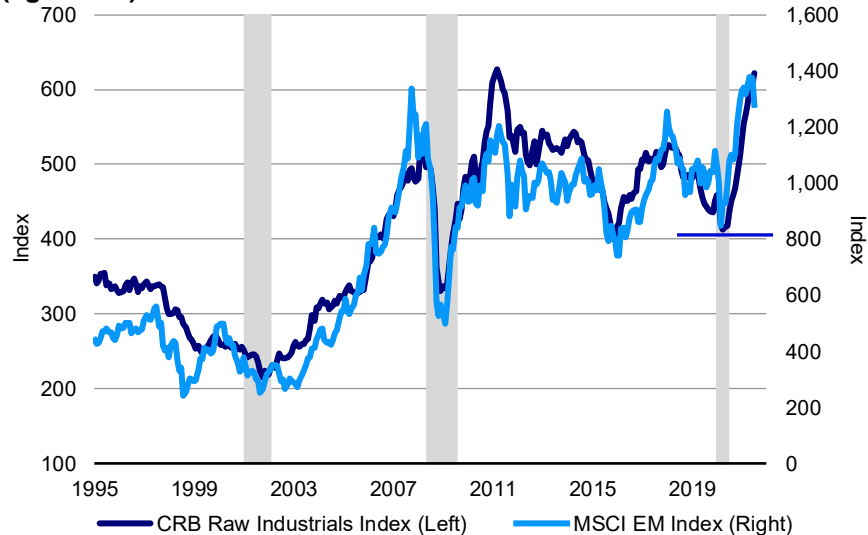
# Geographic revenue exposure – China and commodities – absolute

Chinese demand and commodities have been strong.

China import growth (dark blue) and raw industrial commodity price changes (light blue) since 2006



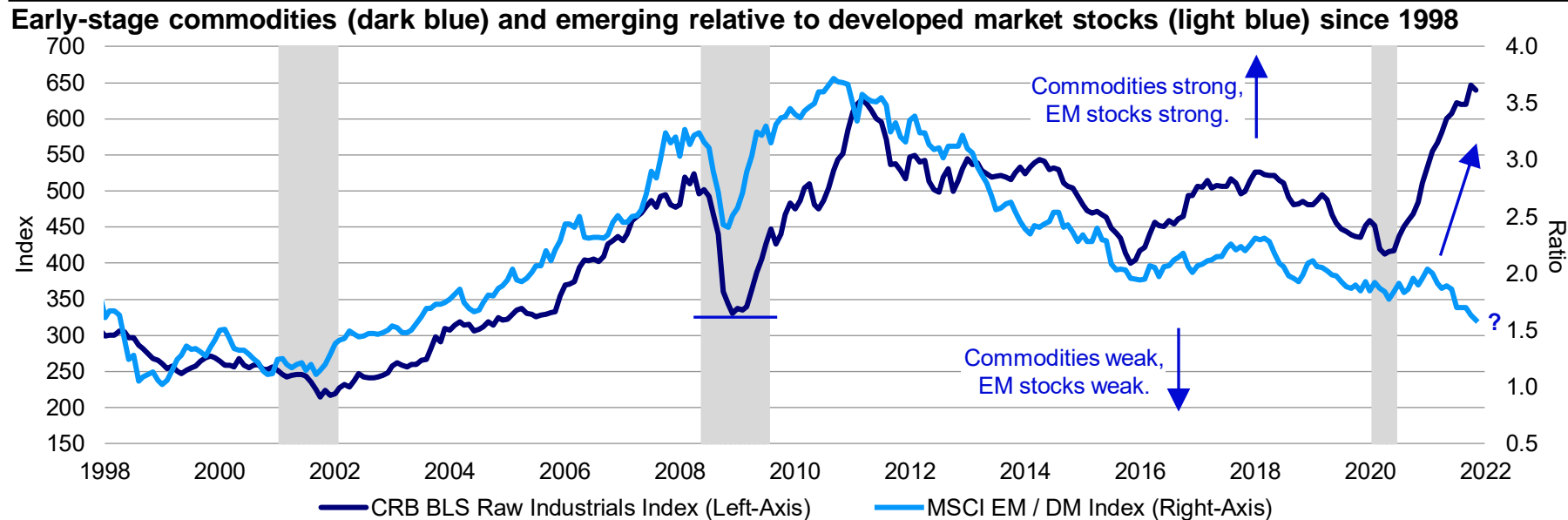
Raw industrial commodity prices (dark blue) and EM stocks (light blue) since 1995



**Sources:** Bloomberg L.P., Haver, Invesco, 11/30/21. **Notes:** CRB = Commodity Research Bureau. MSCI EM Index price returns in US dollars. Shaded areas denote global all-industry contractions. An investment cannot be made into an index. **Past performance does not guarantee future results.**

# Geographic revenue exposure – China and commodities – relative


Emerging markets usually outperformed developed markets when commodity prices were rising. But EM stocks have overreacted and may be poised for a meltup.



**Sources:** Bloomberg L.P., FRED, Invesco, 11/30/21. **Notes:** USD = Trade Weighted USD Index: Emerging Markets Economies, Goods and Services. EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World price indices in US dollars. CRB = Commodity Research Bureau. BLS = Bureau of Labor Statistics. Shaded areas denote global all-industry contractions. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

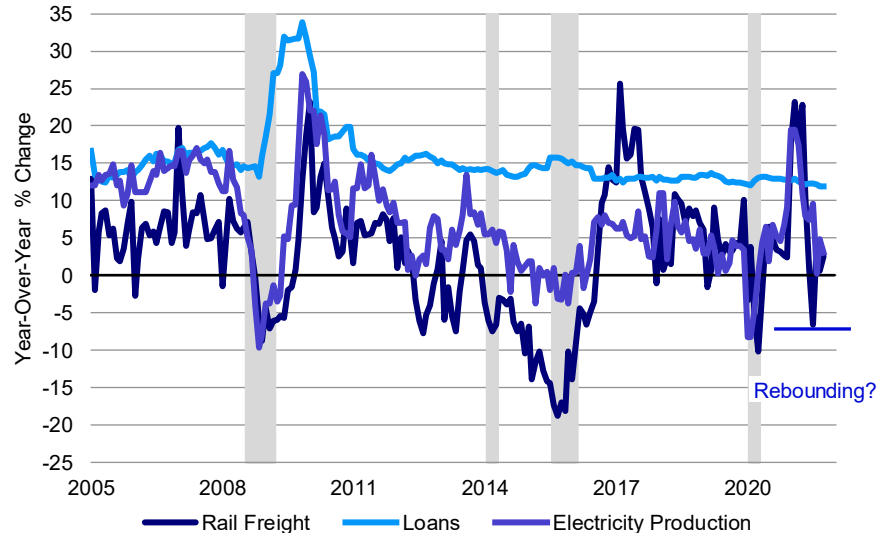
## Geographic revenue exposure – China

Chinese growth downshifted in response to Beijing's overreaction. But activity may be rebounding, led by rail freight.

China Li Keqiang Index changes (dark blue) and China real GDP growth (light blue) since 2005 



China Li Keqiang Index component changes since 2005 



**Sources:** Bloomberg L.P., Macrobond, Invesco, 11/30/21. **Notes:** China Li Keqiang Index = A weighted average of the annual growth rates of outstanding bank loans (40%), electricity production (40%) and rail freight volume (20%). GDP = Gross domestic product. Shaded areas denote China all-industry contractions as defined by Caixin/IHS Markit China Composite Purchasing Managers Index (PMI) readings below 50% for three months or more. An investment cannot be made into an index. **Past performance does not guarantee future results.**



Earnings growth



Has been poor

Back



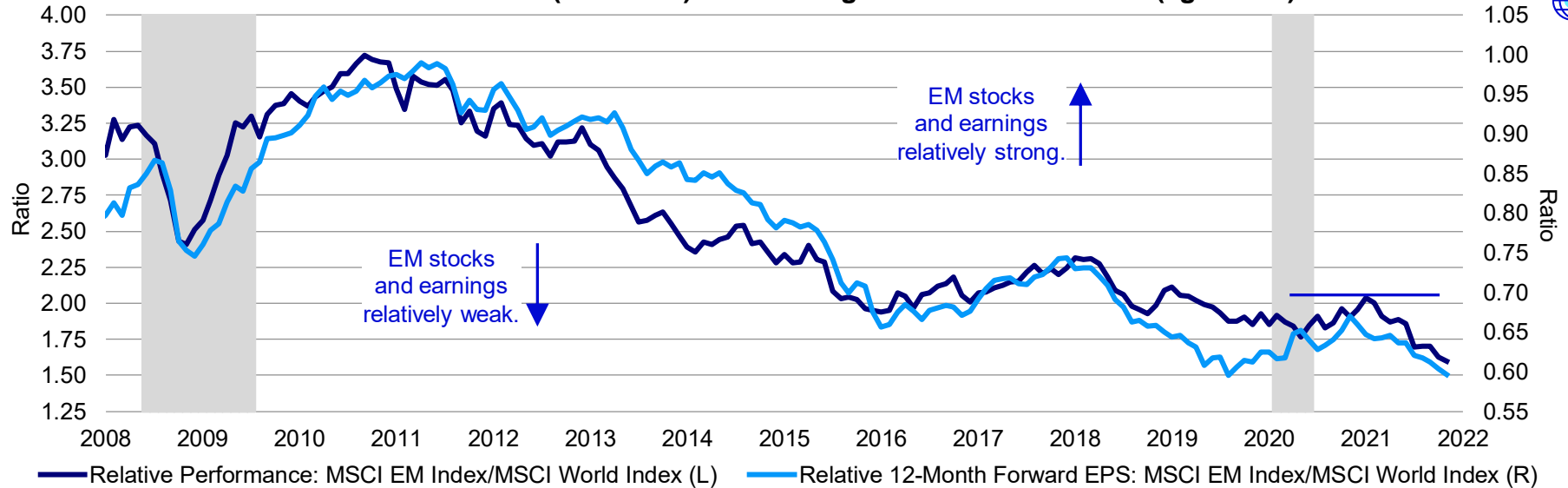
7



# Earnings growth

Expectations have been low for EM, but their earnings profile has remained in favor of DM for now.

Performance of EM relative to DM stocks (dark blue) and earnings of EM relative to DM (light blue) since 2008



**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** MSCI EM and World Index price returns in US dollars. EPS = Earnings per share in US dollars. Shaded areas denote global all-industry contractions. An investment cannot be made into an index. **Past performance does not guarantee future results.**



## Flows and currencies



Have weakened

8,9

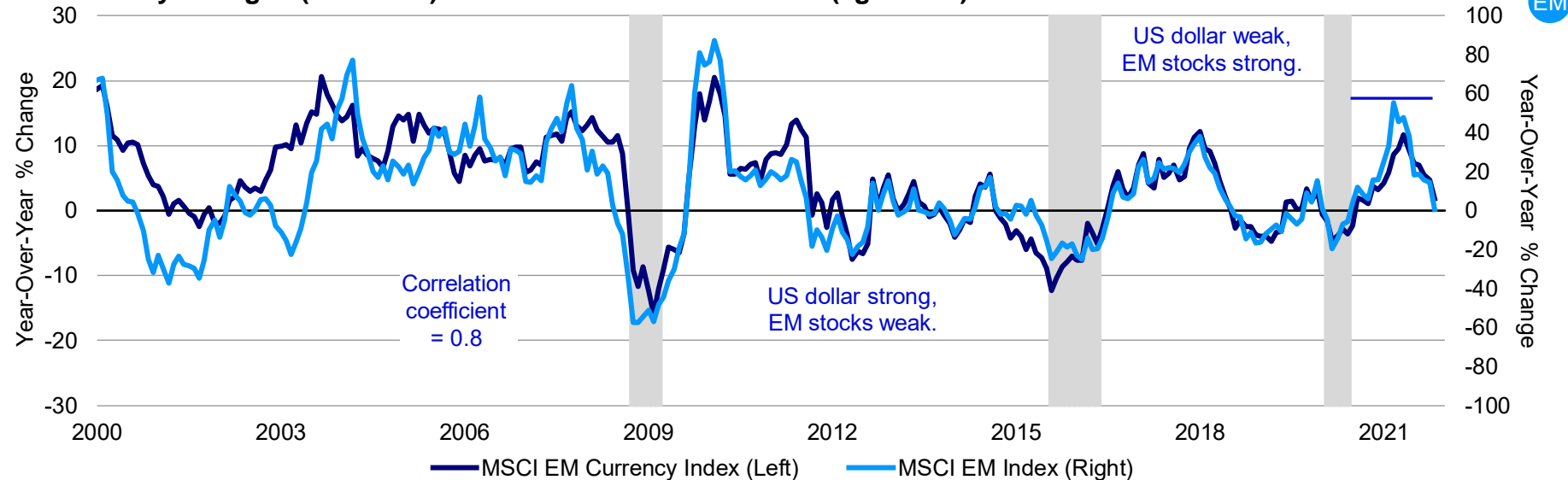
Back



## Flows and currencies – absolute

EM currency weakness (and US dollar strength) has been a headwind for EM stocks.

EM currency changes (dark blue) and EM stock market returns (light blue) since 2000

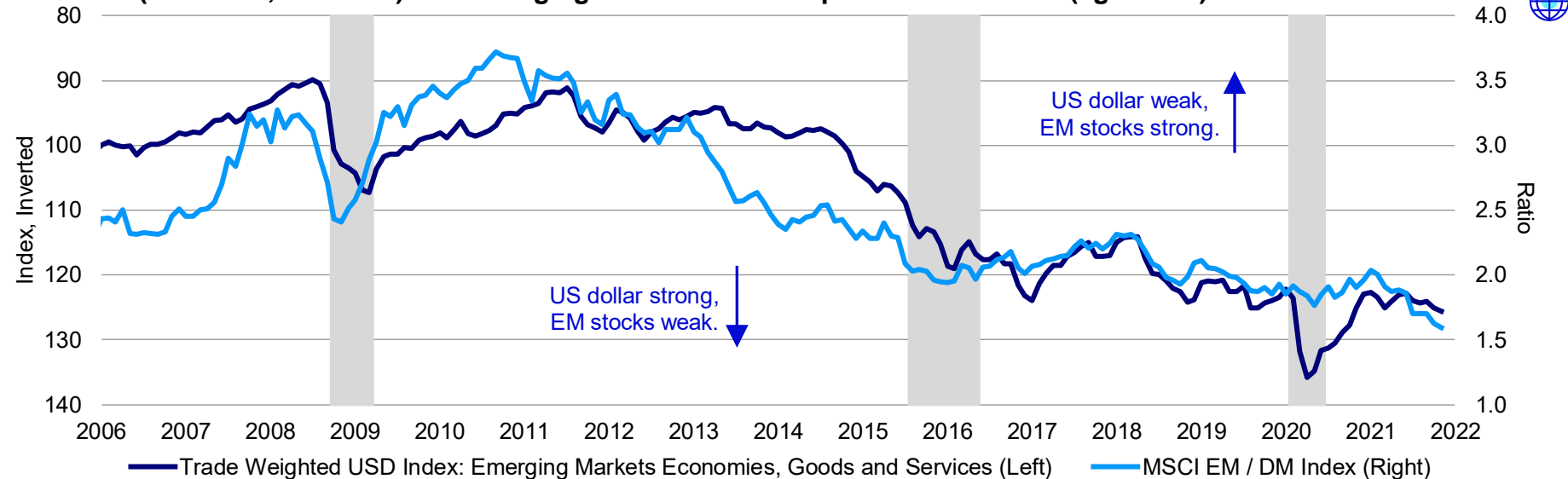


**Sources:** Bloomberg L.P., Invesco, 11/30/21. **Notes:** The MSCI Emerging Markets Currency Index reflects the performance of 25 EM currencies relative to the US dollar. The MSCI EM Currency Index sets the weights of each currency equal to the relevant country weight in the MSCI EM Index. MSCI EM Index price returns in US dollars. Shaded areas denote EM all-industry contractions. An investment cannot be made into an index. **Past performance does not guarantee future results.**

## Flows and currencies – relative

EM stocks underperformed DM stocks when the US dollar strengthened relative to EM currencies, as has recently been the case.

US dollar (dark blue, reversed) and emerging relative to developed market stocks (light blue) since 2006



**Sources:** Bloomberg L.P., FRED, Invesco, 11/30/21. **Notes:** USD = Trade Weighted USD Index: Emerging Markets Economies, Goods and Services = A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that are emerging market economies. EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World price indices in US dollars. Shaded areas denote EM all-industry contractions. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**





## Technicals



EM stocks have been  
oversold

Back

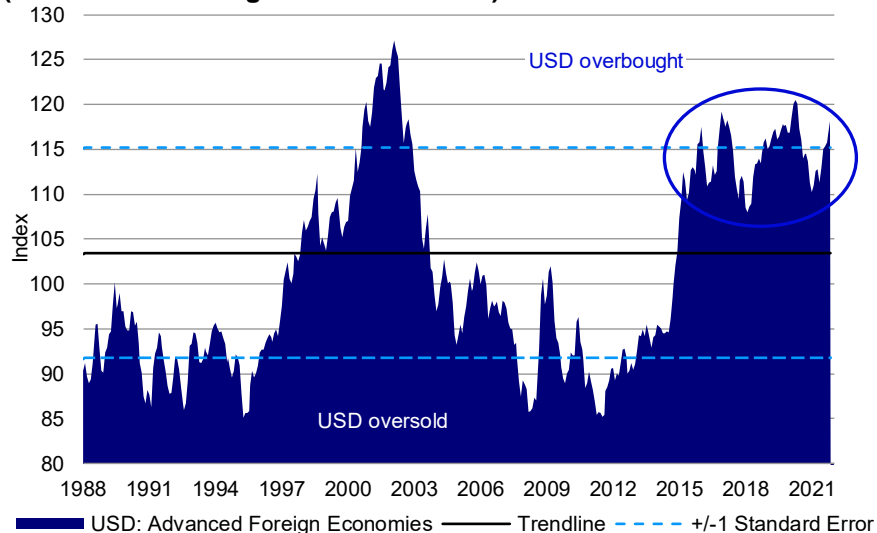


# 10

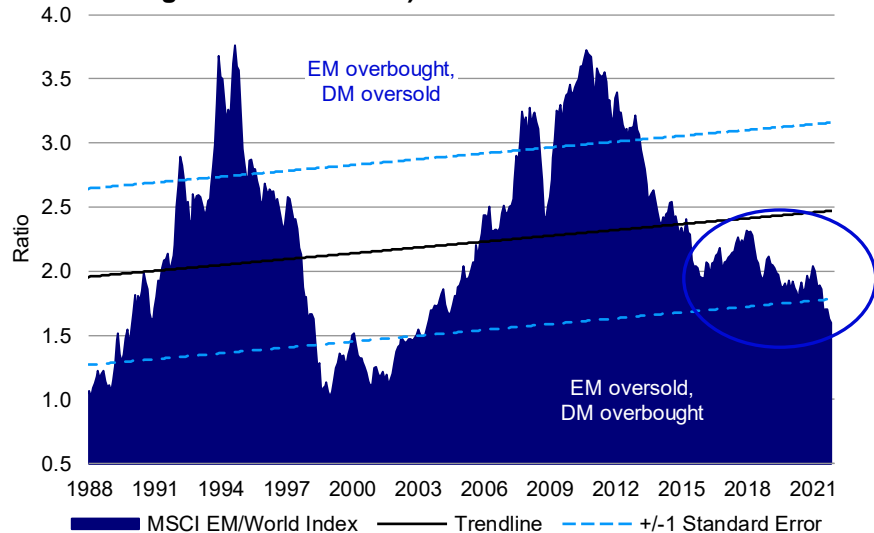
# Technical

The US dollar has remained structurally overbought, the flipside of which has been structurally oversold EM stocks.

The US dollar relative to advanced foreign economies\* since 1988 (trend and overbought/sold thresholds)



Emerging relative to developed market stocks since 1988 (trend and overbought/sold thresholds)



**Sources:** Bloomberg L.P., FRED, Invesco, 11/30/21. **Notes:** \*The Federal Reserve's Real Advanced Foreign Economies Dollar Index. Real = Inflation adjusted. Price indices in US dollars. An investment cannot be made in an index. **Past performance does not guarantee future results.**

# Global Thought Leadership

## Author's biography



---

**Talley Léger**  
Senior Equity Strategist

---

Talley Léger is the Senior Investment Strategist for the Global Thought Leadership team. In this role, he is responsible for formulating and communicating macro and investment insights, with a focus on equities. Mr. Léger is involved in macro research, cross-market strategy, and equity strategy.

Mr. Léger joined Invesco when the firm combined with OppenheimerFunds in 2019. At

OppenheimerFunds, he was the equity strategist. Prior to OppenheimerFunds, he was the founder of Macro Vision Research and held strategist roles at Barclays Capital, ISI, Merrill Lynch, RBC Capital Markets, and Brown Brothers Harriman. Mr. Léger has been in the industry since 2000.

He is the co-author of the revised second edition of the book, "From Bear to Bull with ETFs."\* Mr. Léger

has been a guest columnist for "The Big Picture" and "Data Watch" on Bloomberg Brief Economics, as well as a contributing author on "Seeking Alpha" (seekingalpha.com). He has been quoted in the Associated Press, Barron's, Bloomberg, Business Week, Dow Jones Newswires, The Financial Times, MarketWatch, Morningstar Magazine, The New York Times, and The Wall Street Journal. Mr. Léger has appeared on Bloomberg TV, BNN Bloomberg,

CNBC, Reuters TV, TD Ameritrade, The Street, Yahoo! Finance, and has spoken on Bloomberg Radio.

Mr. Léger earned a master of science in financial economics and a bachelor of music degree from Boston University. He is a member of the Global Interdependence Center (GIC) and holds the General Securities Representative registration.

\*"From Bear to Bull with ETFs" (2nd ed.), by David R. Kotok and Talley Léger, published by Cumberland Advisors Publishing (2014).

# Important information

This document is intended only for investors in Hong Kong, for Institutional Investors and/or Accredited Investors in Singapore, for certain specific sovereign wealth funds and/or Qualified Domestic Institutional Investors approved by local regulators only in the People's Republic of China, for certain specific Qualified Institutions and/or Sophisticated Investors only in Taiwan, for Qualified Professional Investors in Korea, for certain specific institutional investors in Brunei, for Qualified Institutional Investors and/or certain specific institutional investors in Thailand, for certain specific institutional investors in Malaysia upon request, for certain specific institutional investors in Indonesia and for qualified buyers in Philippines for informational purposes only. This document is not an offering of a financial product and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any unauthorized person is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements," which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.

This document is issued in the following countries:

- in Hong Kong by Invesco Hong Kong Limited 景順投資管理有限公司, 41/F, Champion Tower, Three Garden Road, Central, Hong Kong. This document has not been reviewed by the Securities and Futures Commission.
- in Singapore by Invesco Asset Management Singapore Ltd, 9 Raffles Place, #18-01 Republic Plaza, Singapore 048619.
- in Taiwan by Invesco Taiwan Limited, 22F, No.1, Songzhi Road, Taipei 11047, Taiwan (0800-045-066). **Invesco Taiwan Limited is operated and managed independently.**