ETF

Focus

ETFs, a simple way to capture Emerging Markets potential growth

Emerging markets (EM) represent a big part of global markets and are showing good signs of recovery in 2019, so cannot be anymore ignored by investors.

Emerging markets had a challenging year in 2018. Four interest rate hikes by the US Federal Reserve strengthened the dollar and increased debt repayments for those emerging market economies which borrow in dollar.

But the fortunes of emerging markets look set to change, as the macroeconomic and investment environment once again starts to appear slowing down for developed economies.

Renewed interest by investors in emerging markets since the beginning of 2019 supports that view, with more than half of the ETF market's inflows going these exposures.

Momentum for growth – EM versus DM

Developed markets have seen greater momentum in their economic growth compared to emerging markets in recent years, but there are signs that is about to change. In the US, normalisation of monetary policy is likely to lead to a growth slowdown, especially in a context whereby fiscal policy changes such as tax reform introduced by President Trump start to lose their initial impact. Even if the Federal Reserve pauses or slows down its planned rate hikes, the monetary policy environment would remain less easy than it has been in the past. **And any such pause would be all the better for emerging markets, helping to alleviate some of the pain caused by stronger dollar**.

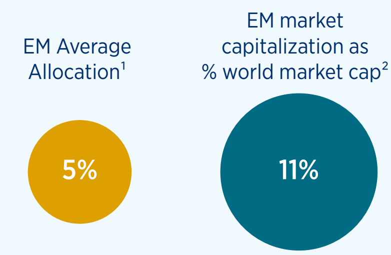
Meanwhile in Europe, although a significant slowdown in overall growth is not expected, earnings growth is likely to have already peaked. Even if the European Central Bank refrains from hiking rates too soon, across the continent growth is expected to plateau in 2019.

In this context, emerging markets could perform comparatively better, and see a stabilization and improvement of the economy in 2019. In China, positive action is being taken to pursue a more sustainable growth path. This is good news for emerging markets as a whole, which are sensitive to China's performance.

Rather than artificially inflating growth through excessive infrastructure projects, there is now serious endeavour underway in China to inject money into the real economy via the banking system. Investors are noticing, and in turn are beginning to reallocate to emerging markets-where they typically remain underweight. ■

An underrespresented asset class in investor portfolios

Emerging Markets represent only **5% on average in investor portfolio[1],** a very low proportion compared to the share of MSCI EM on the World index in terms of markets captitalization[2]



1. Source: Amundi Analysis on Bloomberg. BAML Mercer European Asset Allocation Survey 2017. Data as of 31 december 2017
2. Source MSCI, https://www.msci.com/emerging-markets

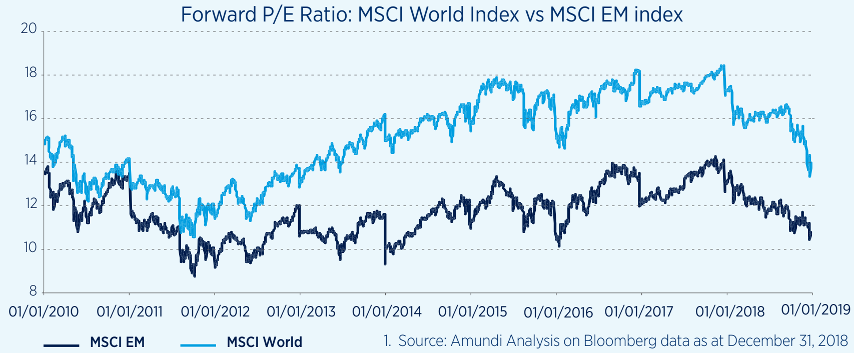
Risk-return favours equities

Although emerging market fixed income has proven popular in recent years, the evolving interest rate environment implies a better risk-return ratio for equities. When rates were kept at either very low or negative levels, emerging market debt became attractive.

But adjustments to rates by the US central bank have driven Treasuries higher, lessening the difference in yield between US and emerging market debt and calling into question whether the excess risk involved remains warranted.

EM P/E valuation remains attractive vs developed economies

Forward P/E Ratio: MSCI World Index vs MSCI EM index



1. Source: Amundi Analysis on Bloomberg data as at December 31, 2018

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In equities, it is a different story. **From a risk-return perspective, there is more for investors to gain by switching their allocations from developed to emerging market equities than from developed to emerging market debt.** Emerging market equities are also cheaper than their developed market counterparts, as well as compared with their own historical levels. That makes the timing for buying into the asset class in this way attractive. **Equities provide an entry point into emerging markets, at a price below that on offer for both developed market securities generally and emerging market bonds.** With emerging economies today accounting for almost 60% of the world's GDP, the case for increasing exposure to this part of the world is difficult to refute. The more important question is how to do that in the best possible way to capture the opportunities on offer. ■

ETFs as an entry point

Amid this context, what is the most effective way of investors gaining exposure to the asset class? The inevitable occurrence of 'special situations', as seen in Argentina and Turkey in 2018, makes it difficult to pick and choose winners within emerging markets. **A simpler, alternative approach is to invest in global emerging market ETFs, or a particular region, enabling investors to increase their allocation to the asset class without having to put all their eggs in one-or two-baskets**.

Investing through ETFs is also more efficient than trying to purchase EMs securities directly, which is expensive and more difficult to handle, notably in terms of liquidity. **ETFs have the advantage of giving investors exposure to several countries, regions and currencies in a single trade, allowing diversification in order to reduce overall risk.** ■

Conclusion

AMUNDI ETF offers a wide, consistent and cost-efficient range of EM equity ETFs, with the possibility to get a broad, region or country specific exposure.

With 8.6bn€[2] of AUM at end January 2019, the franchise of AMUNDI ETF on EM equities is constantly sought after by investors:

Global equity exposures	
■ MSCI EMERGING MARKETS (synthetic) ■ MSCI EMERGING MARKETS DR (physical)	**0.20%** OGC[1]
Regional exposures	
■ MSCI EM ASIA	**0.20 %** OGC[1]
■ MSCI EM LATINA AMERICA	**0.20%** OGC[1]
■ MSCI EASTERN EUROPE EX RUSSIA	**0.20%** OGC[1]
Country exposures	
■ MSCI INDIA	**0.80%** OGC[1]
■ MSCI BRAZIL	**0.55%** OGC[1]
■ MSCI CHINA	**0.55%** OGC[1]

1. Ongoing charges - annual, all taxes included . The ongoing charges represent the charges taken from the fund over a year. When the fund has closed its accounts for the first time, the ongoing charges are estimated.
Transaction cost and commissions may occur when trading ETFs
2. Source: Amundi ETF, Indexing & Smart Beta as of 31/12/2018

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