

Challenges and opportunities in emerging market stocks

Equity Strategy Playbook

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1. Market cycles

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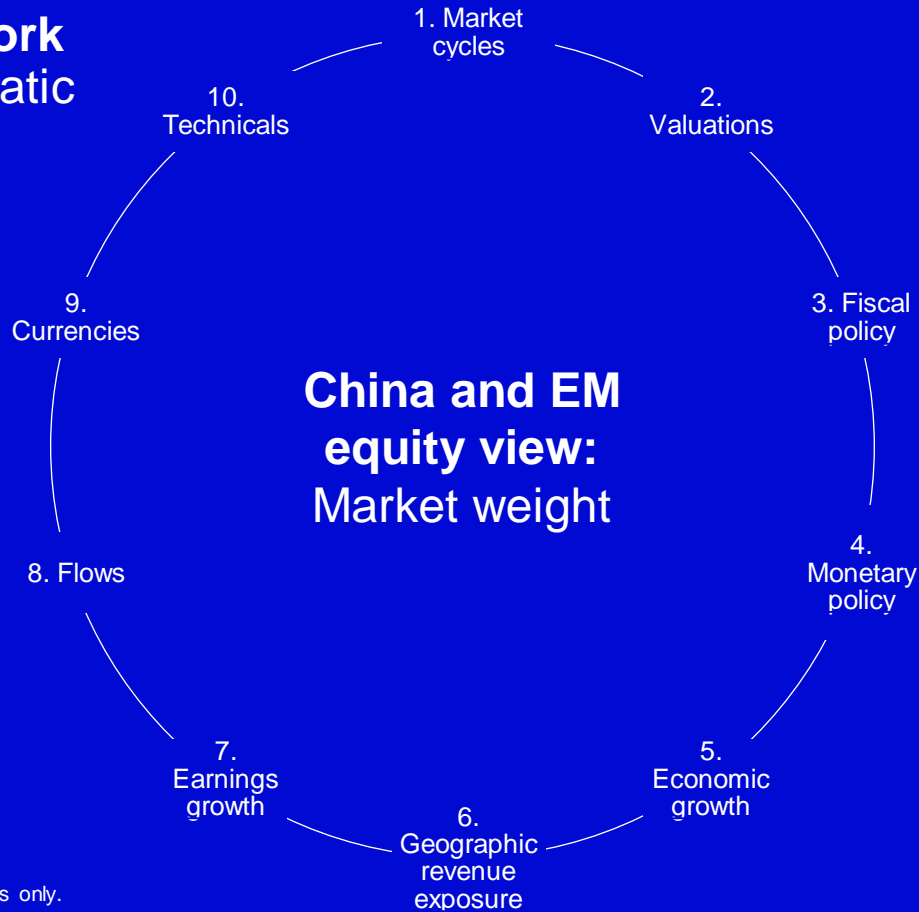
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Multifactor framework

A consistent, systematic method



- A) Cycle: 1
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Source: Invesco. Note: For illustrative purposes only.

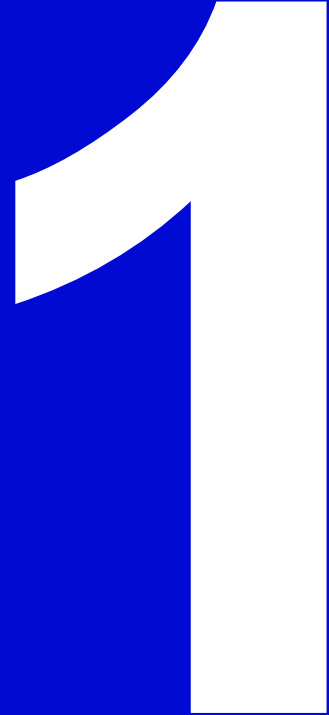


Market cycles



The trend isn't your friend.

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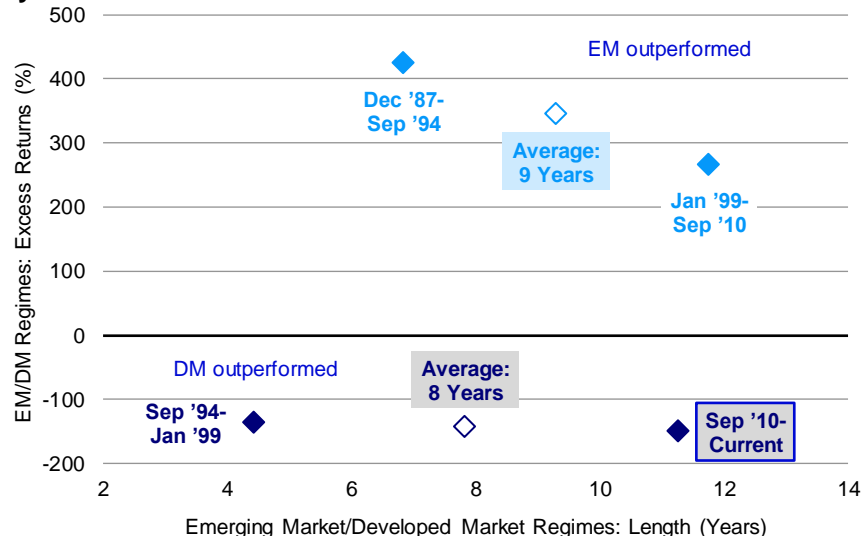
Market cycles

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

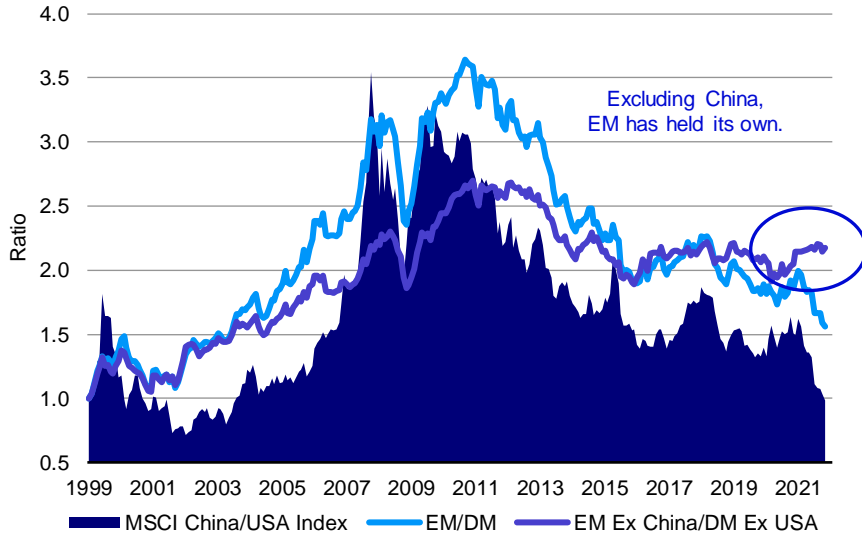


Sources: Bloomberg L.P., Invesco, 11/30/21. **Notes:** EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World Index price returns in US dollars. See page 36 for index definitions. An investment cannot be made into an index. **Past performance does not guarantee future results.**

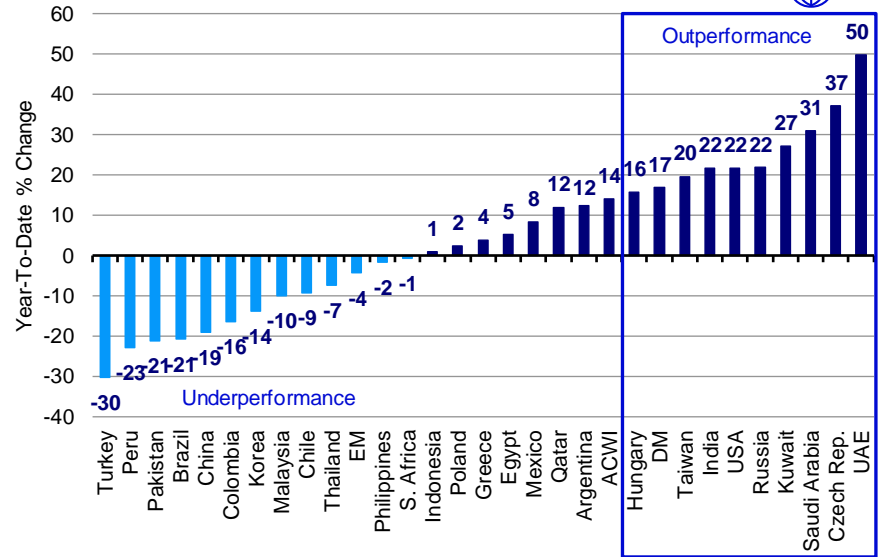
Market cycles

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. See page 36 for index definitions. An investment cannot be made into an index. **Past performance does not guarantee future results.**



Valuations



Are cheap

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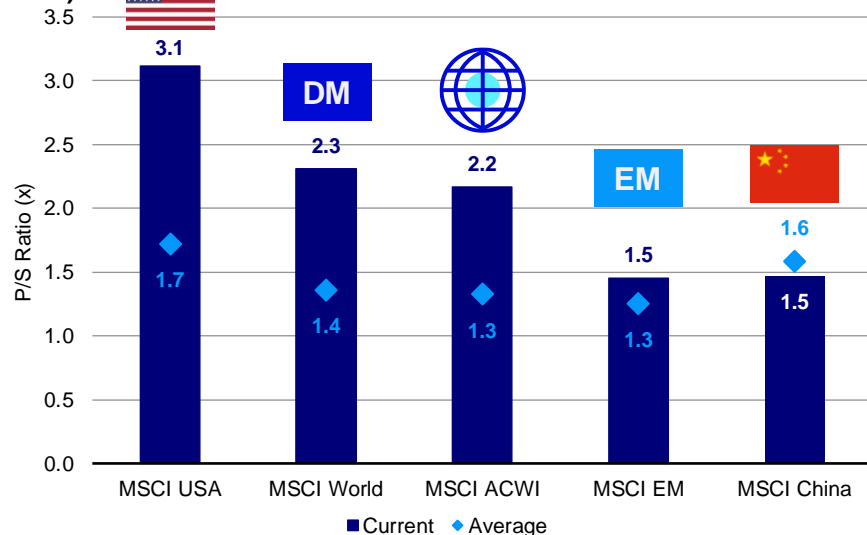


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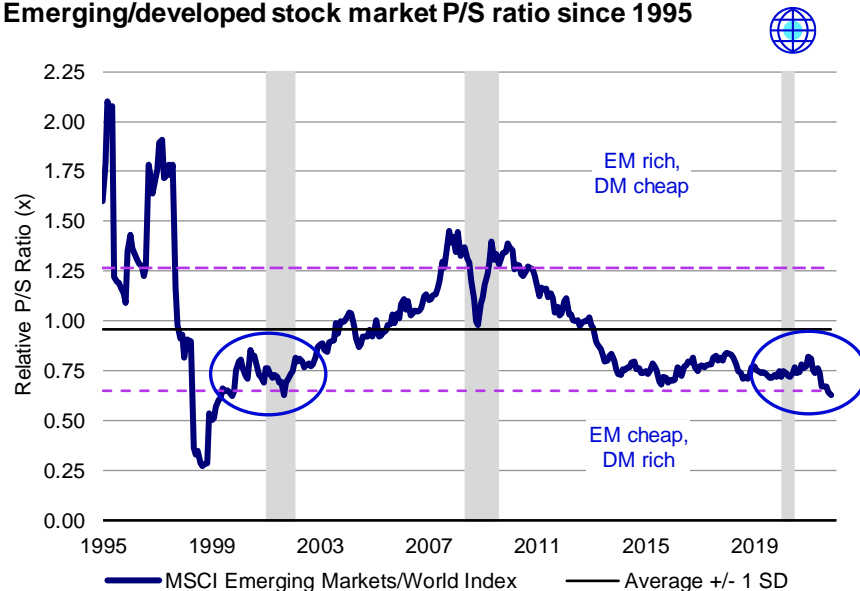
Valuations – regions

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)



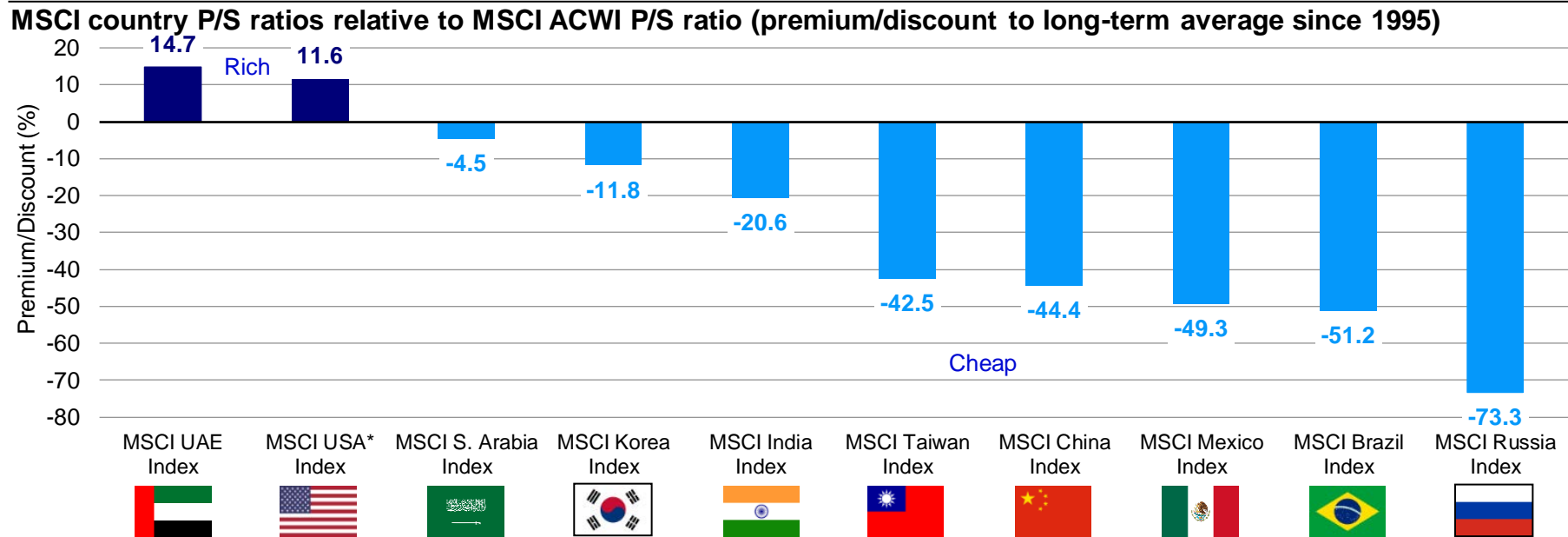
Emerging/developed stock market P/S ratio since 1995



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. See page 36 for index definitions. **Past performance does not guarantee future results.**

Valuations – countries

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

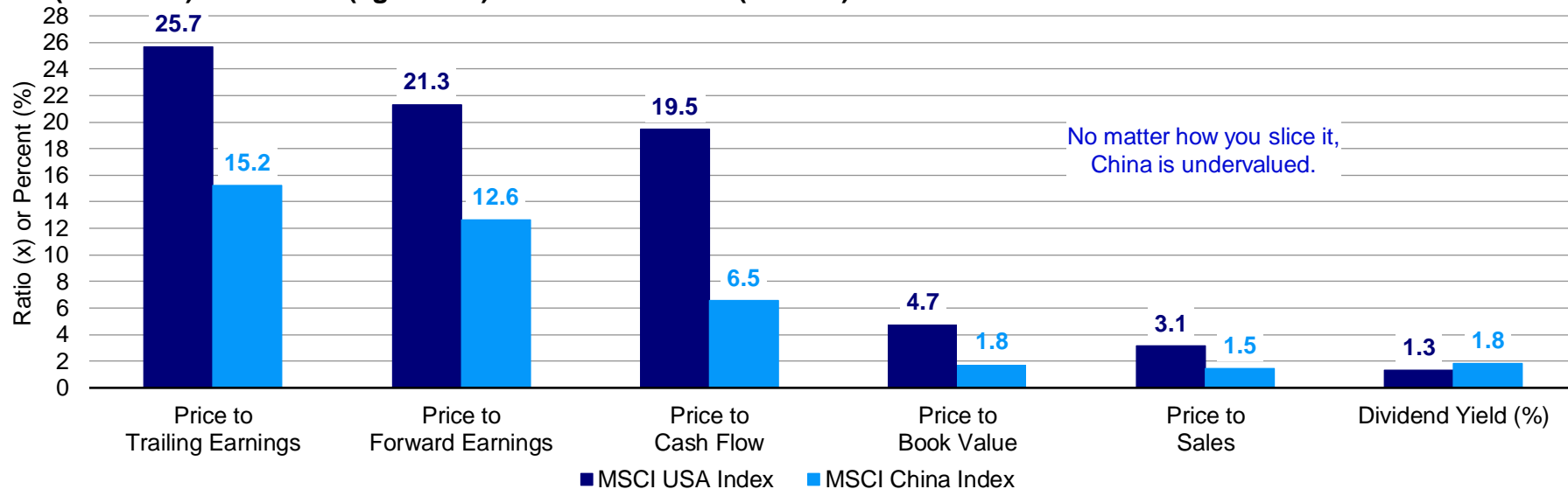


Sources: Bloomberg L.P., Invesco, 11/30/21. **Notes:** BRICs = Brazil, Russia, India and China. UAE = United Arab Emirates. Ranked from left to right—from biggest premium to biggest discount. *We included the USA for comparison purposes only. An investment cannot be made into an index. See page 36 for index definitions. **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. See page 36 for index definitions. 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

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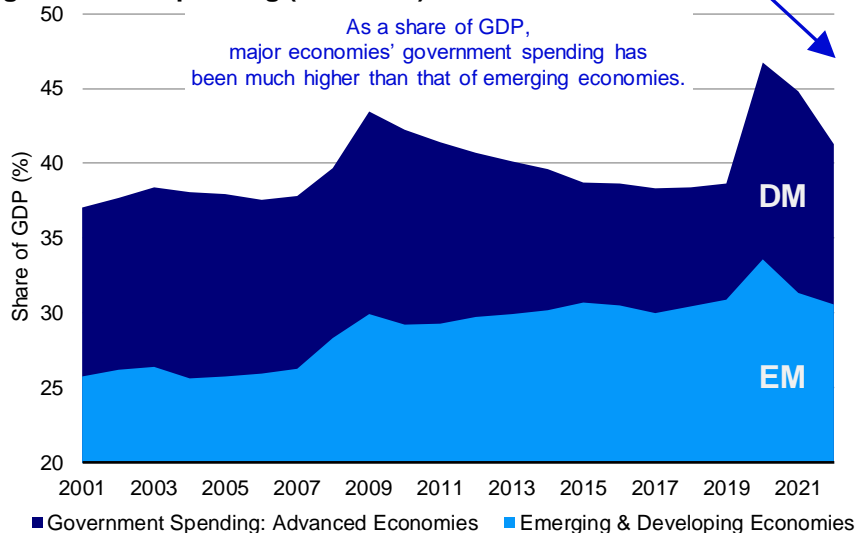


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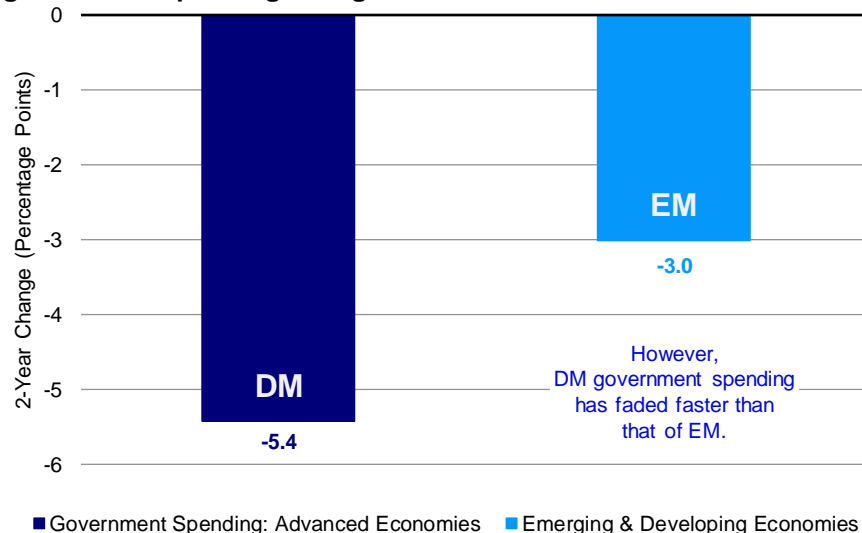
Fiscal policy – government spending

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

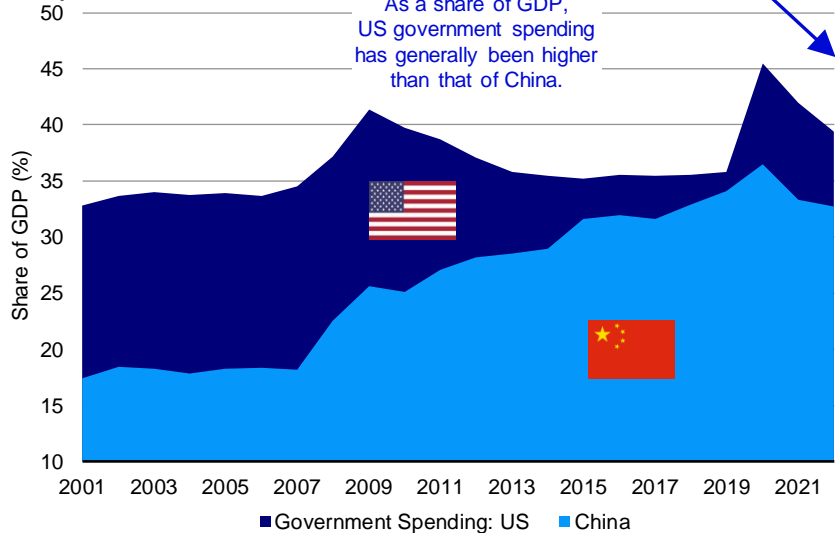


Sources: IMF World Economic Outlook database, Invesco, 11/30/21. **Notes:** DM = Developed economies. EM = Emerging economies. General government total expenditure. GDP = Gross domestic product. **Past performance does not guarantee future results.**

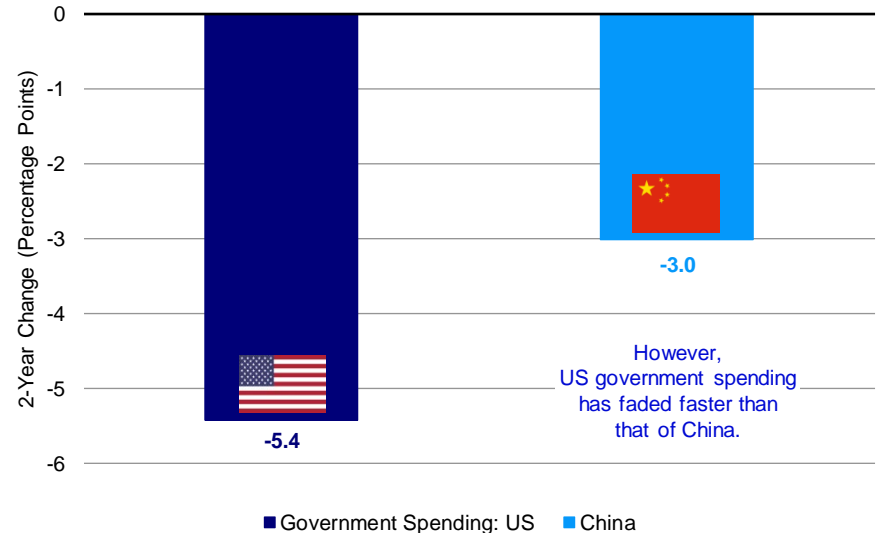
Fiscal policy – government spending – US and China

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

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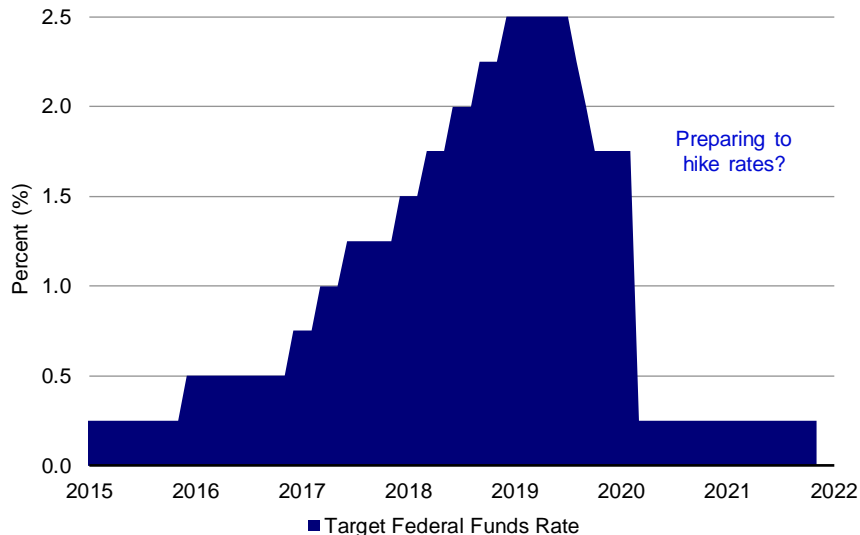


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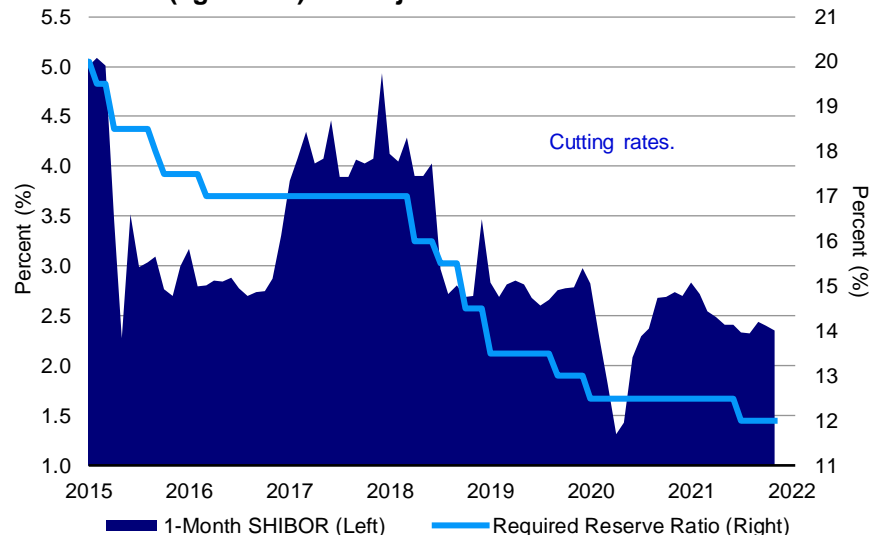
Monetary policy – interest rates

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

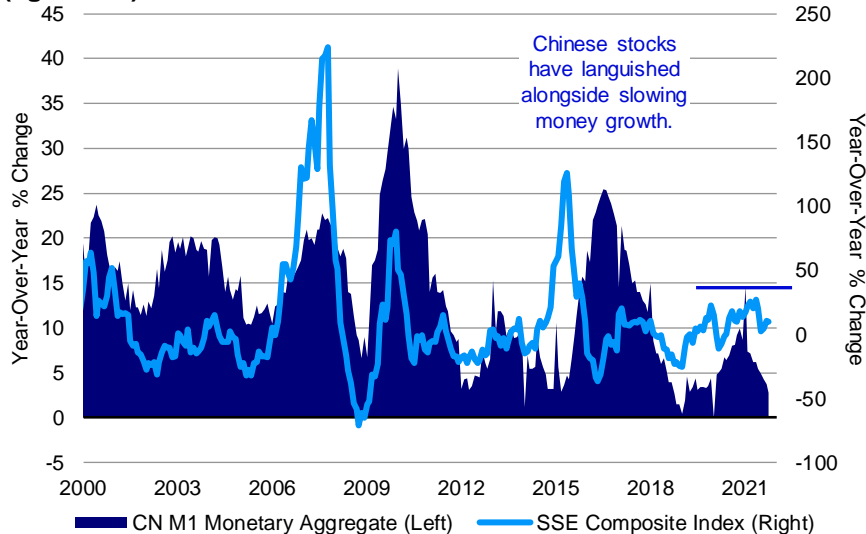


Sources: Bloomberg L.P., FRED, Invesco, 11/30/21. Notes: SHIBOR = Shanghai Interbank Offered Rate. Past performance does not guarantee future results.

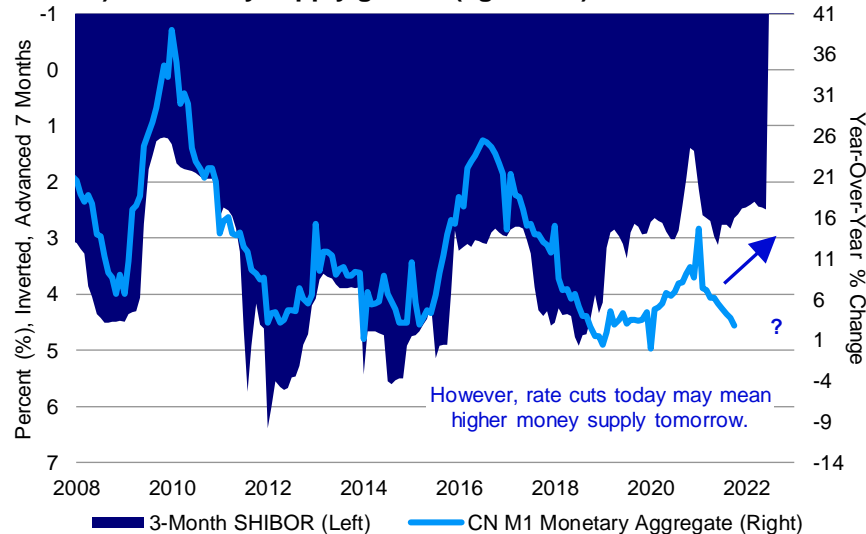
Monetary policy – money supply

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

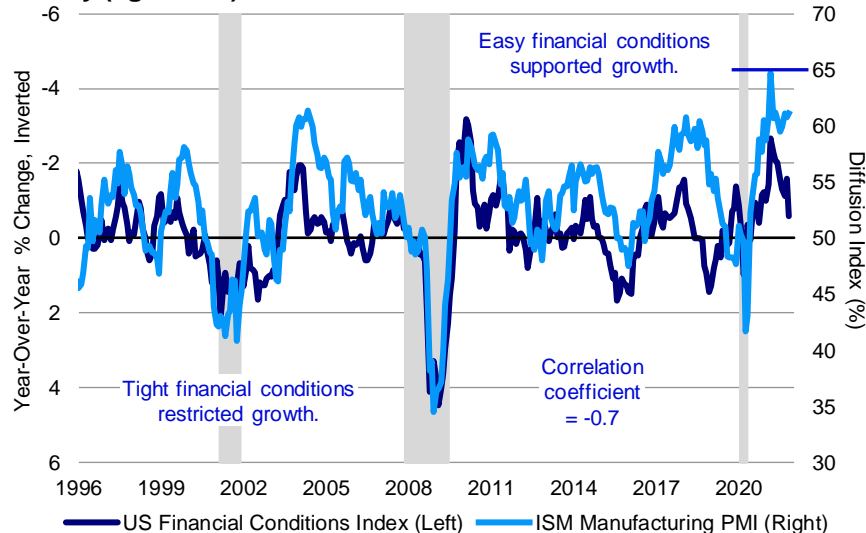


Sources: Bloomberg L.P., Macrobond, People's Bank of China, Invesco, 11/30/21. **Notes:** CN = China. SSE = Shanghai Stock Exchange. SHIBOR = Shanghai Interbank Offered Rate. M1 and SSE Composite Index in yuan. An investment cannot be made in an index. See page 36 for index definitions. **Past performance does not guarantee future results.**

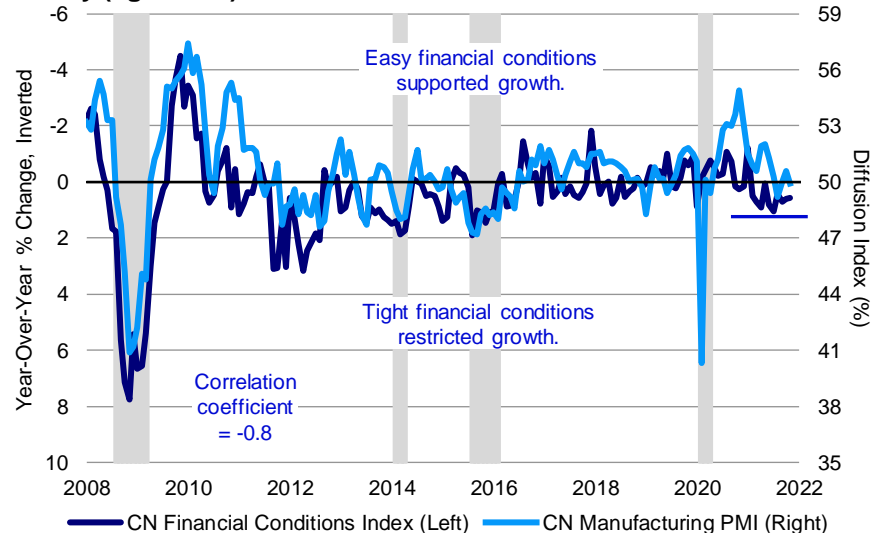
Monetary policy – financial conditions

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. See page 36 for index definitions. **Past performance does not guarantee future results.**



Economic growth



Has slowed for EM, but
global growth remains robust

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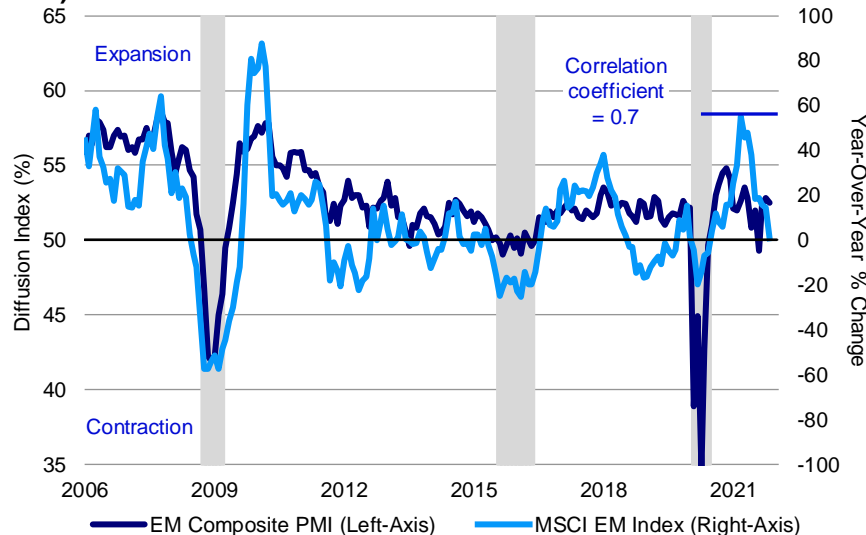


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Economic growth – absolute

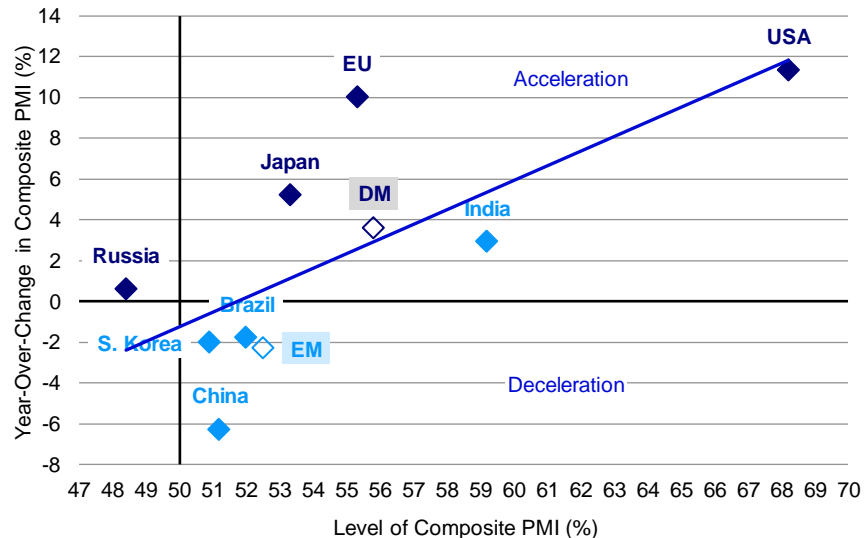
EM activity has grown, albeit at a slower pace than DM.

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



EM

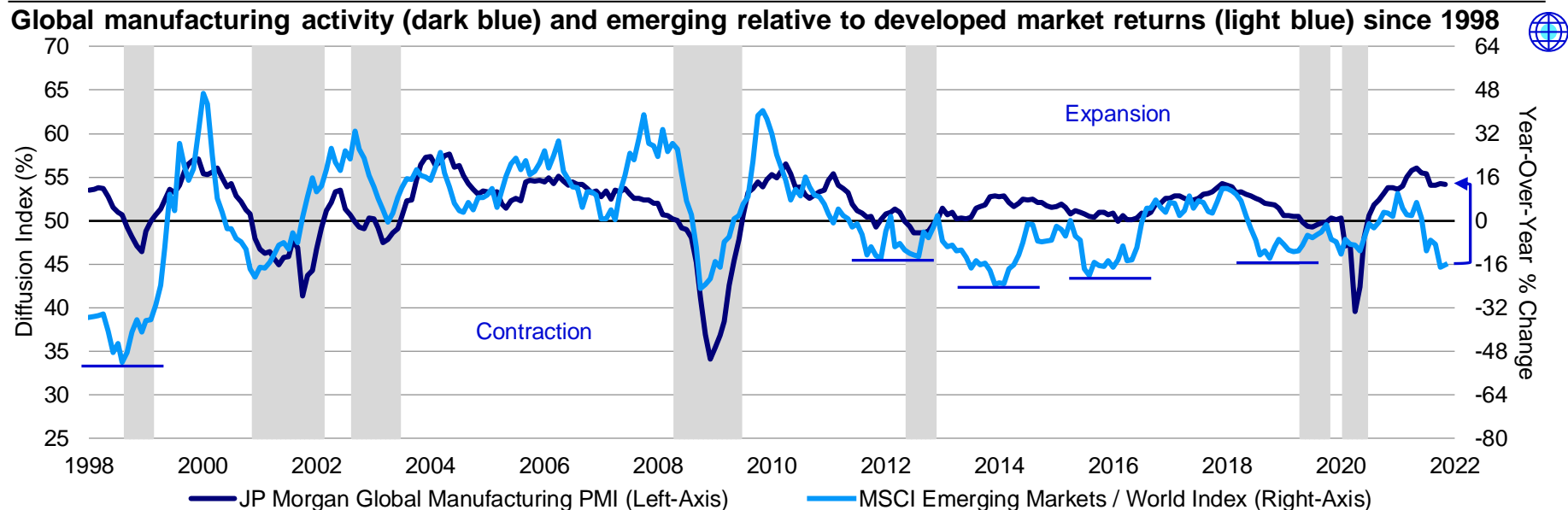
Global business cycle clock (current)



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. See page 36 for index definitions. 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.

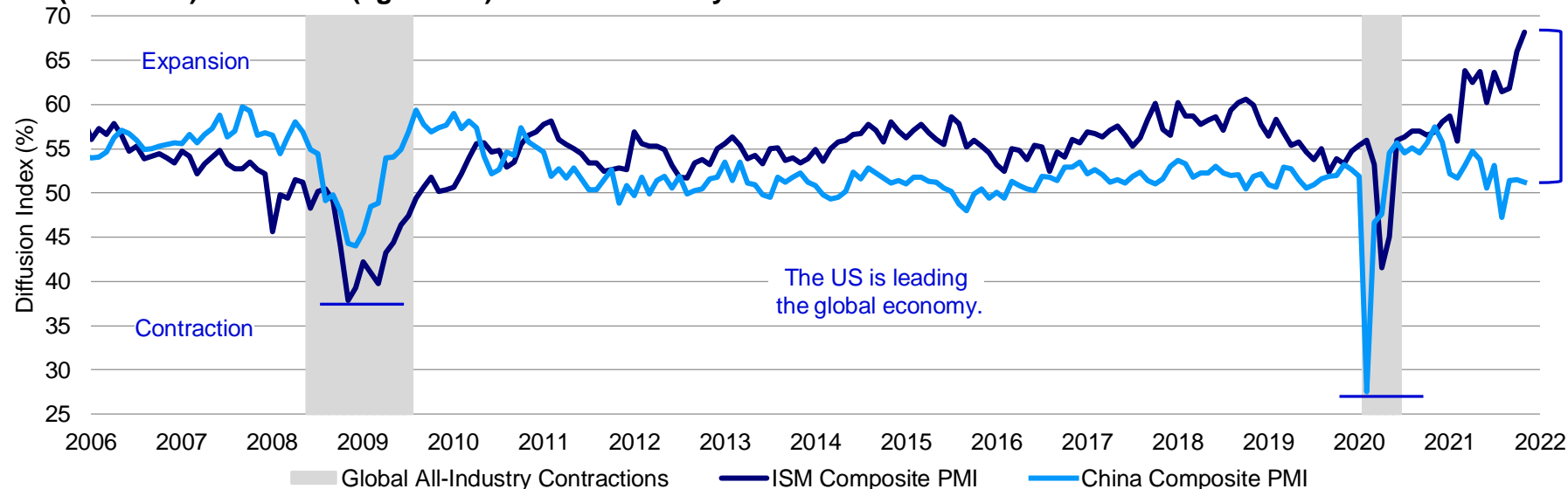


Sources: Bloomberg L.P., Macrobond, Invesco, 11/30/21. **Notes:** EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World price indices in US dollars. Shaded areas denote global manufacturing contractions. See page 36 for index definitions. An investment cannot be made directly 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

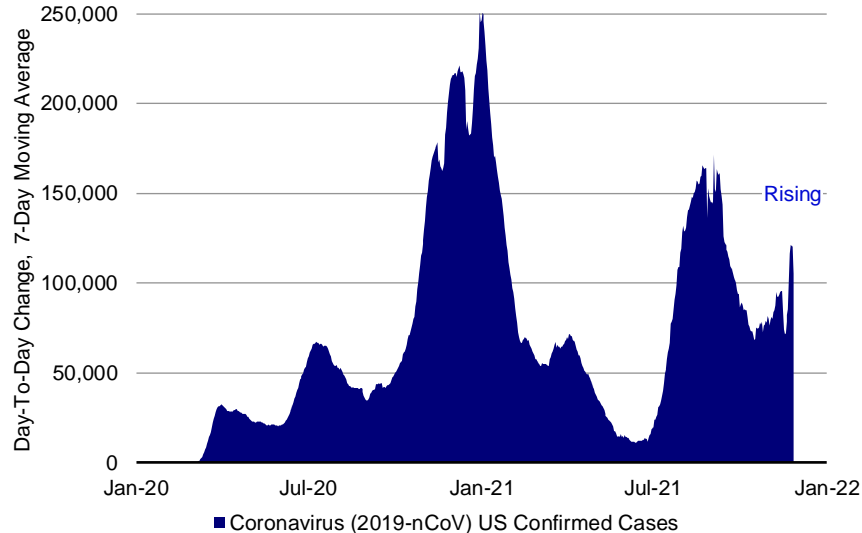


Sources: Caixin/IHS Markit, Macrobond, Invesco, 11/30/21. **Notes:** Composite = Manufacturing + services. ISM = Institute for Supply Management. PMI = Purchasing managers index. Diffusion indices have the properties of leading indicators and are convenient summary measures showing the prevailing direction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

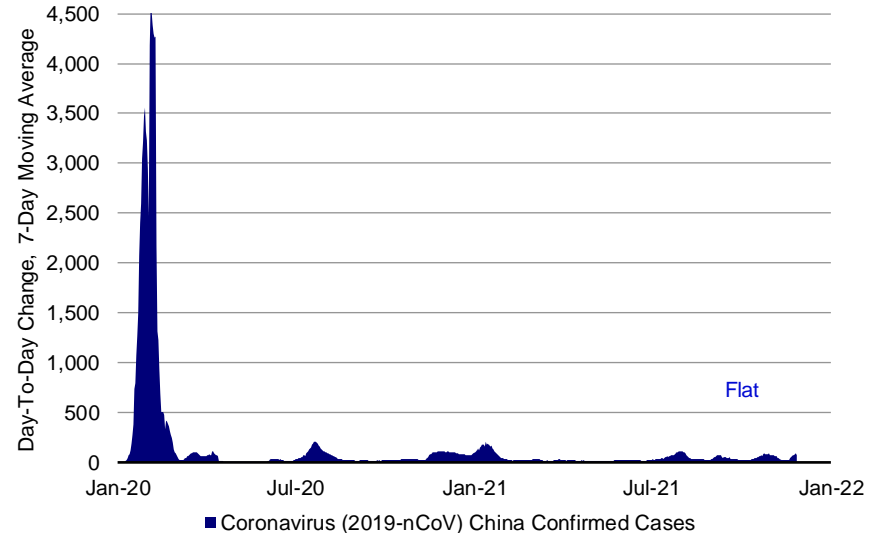
Economic growth – coronavirus – US and China

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

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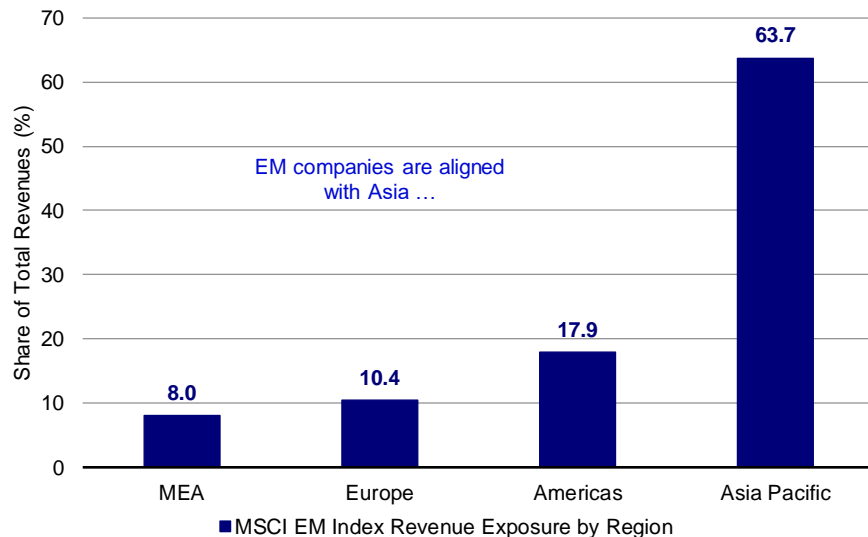


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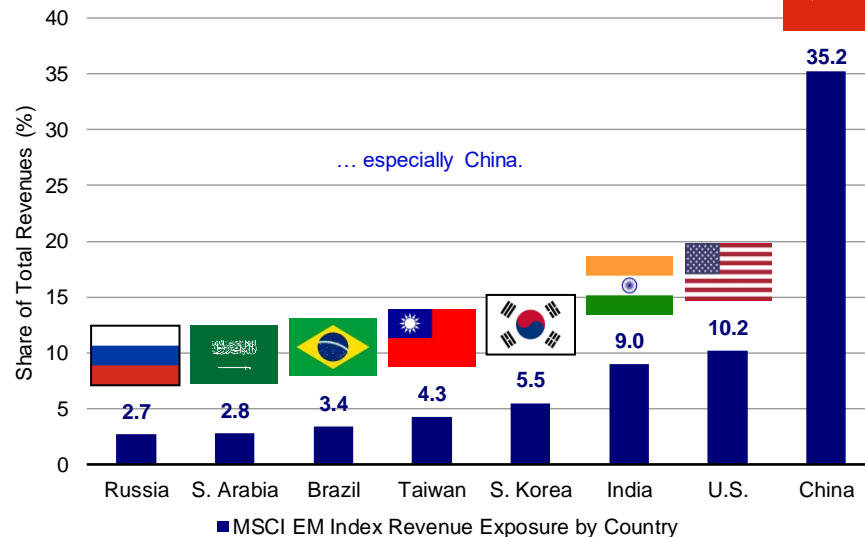
Geographic revenue exposure – China

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)

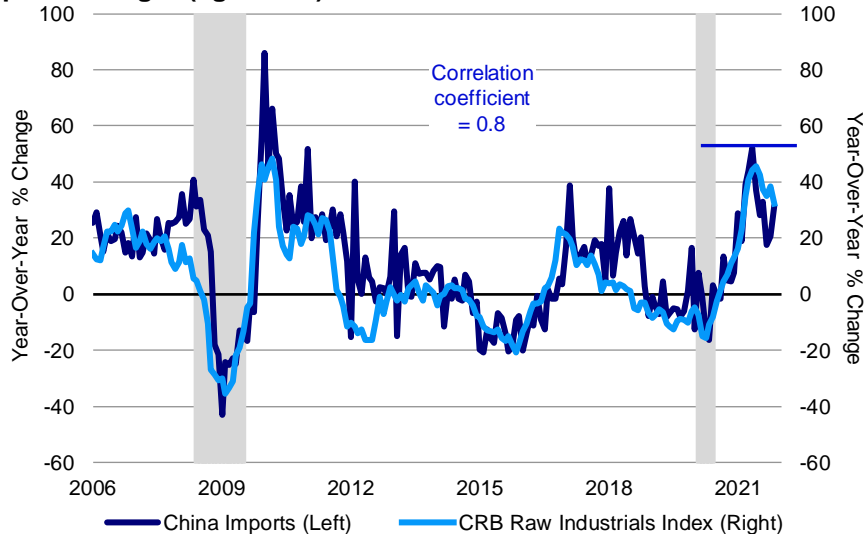


Sources: FactSet, Invesco, 11/30/21. Notes: MEA = Middle East and Africa. ID = Indonesia. See page 36 for index definitions. Past performance does not guarantee future results.

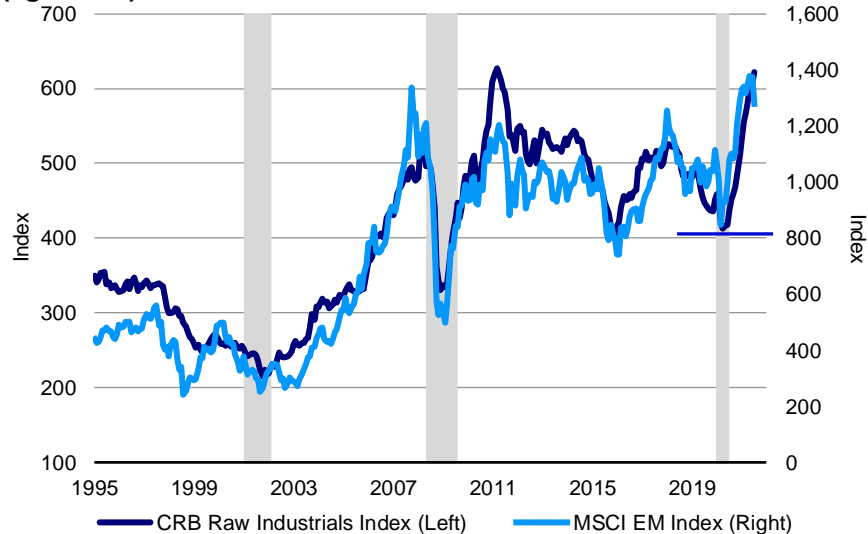
Geographic revenue exposure – China and commodities – absolute

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

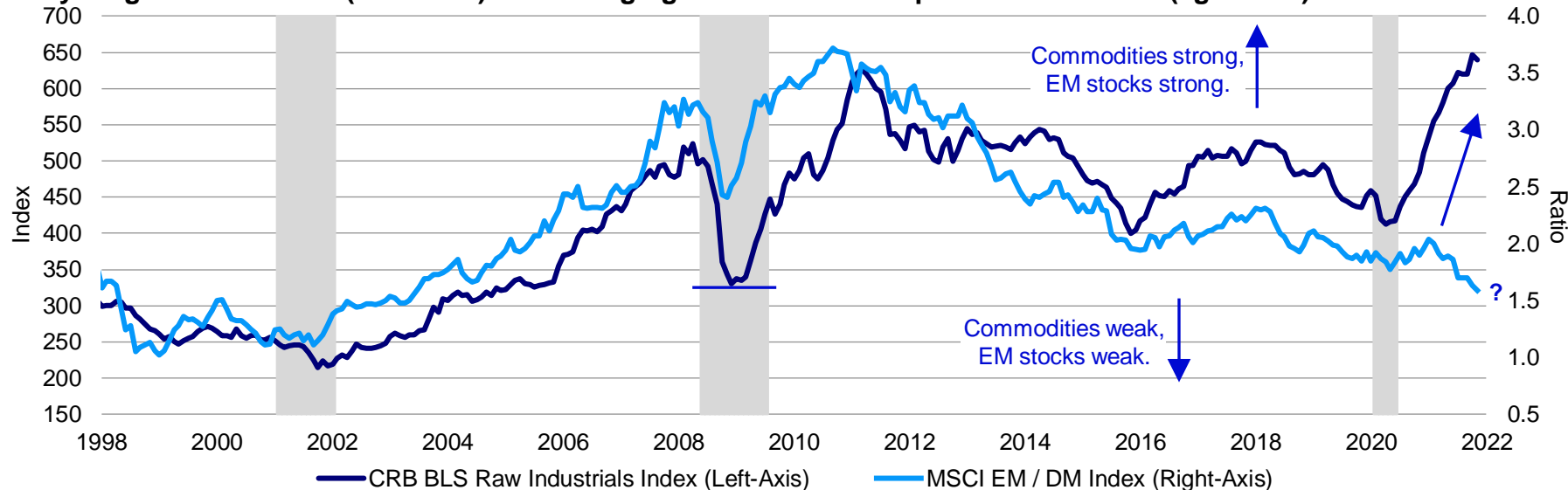


Sources: Bloomberg L.P., Haver, Invesco, 11/30/21. **Notes:** CRB = Commodity Research Bureau. MSCI EM Index price returns in US dollars. Shaded areas denote global all-industry contractions. See page 36 for index definitions. An investment cannot be made into an index. **Past performance does not guarantee 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.


Early-stage commodities (dark blue) and emerging relative to developed market stocks (light blue) since 1998




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. See page 36 for index definitions. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

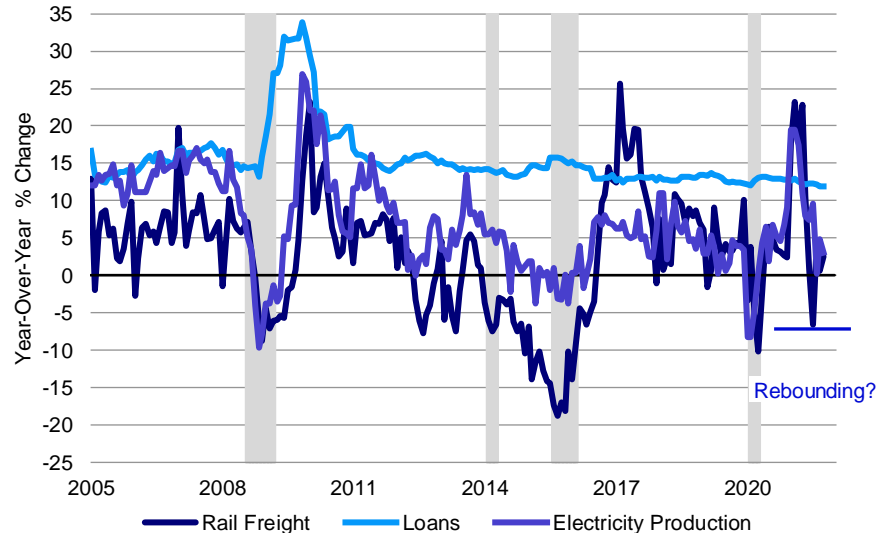
Geographic revenue exposure – China

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. See page 36 for index definitions. An investment cannot be made into an index. **Past performance does not guarantee future results.**



Earnings growth



Has been poor

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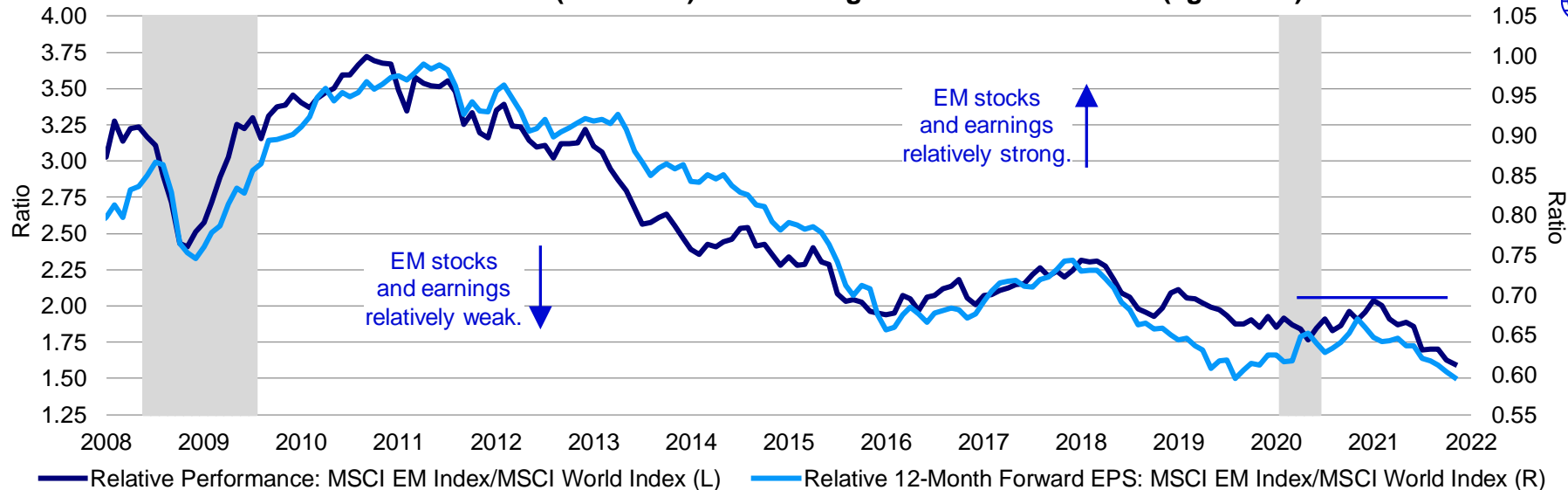


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Earnings growth

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. See page 36 for index definitions. An investment cannot be made into an index. **Past performance does not guarantee future results.**



Flows and currencies



Have weakened

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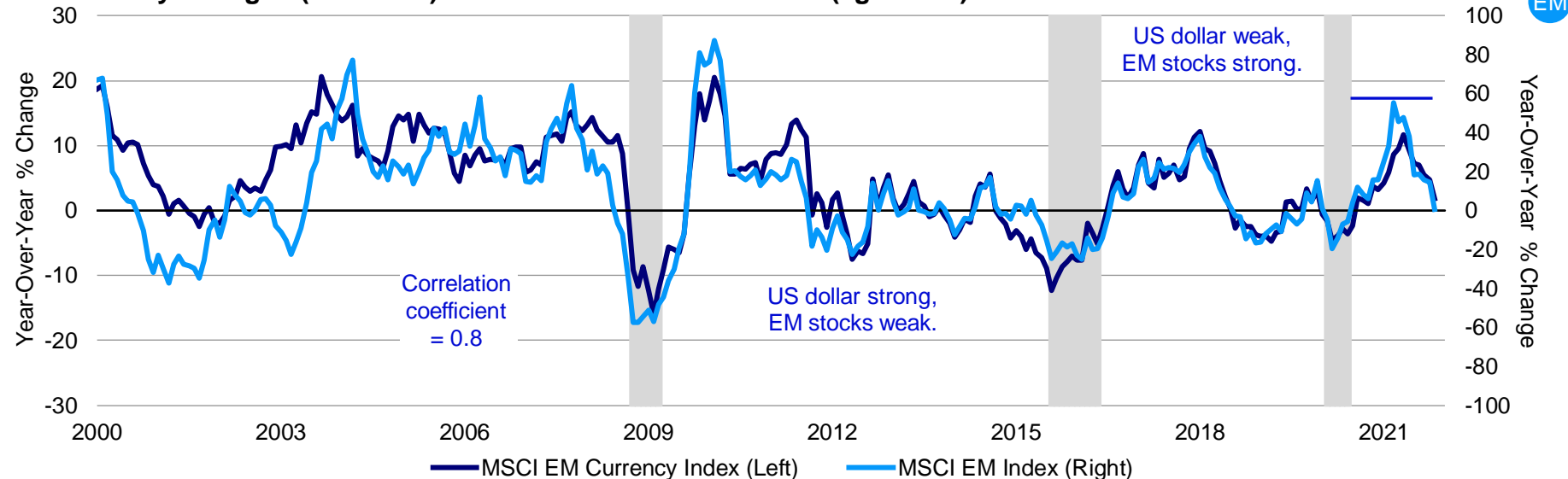
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Flows and currencies – absolute

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



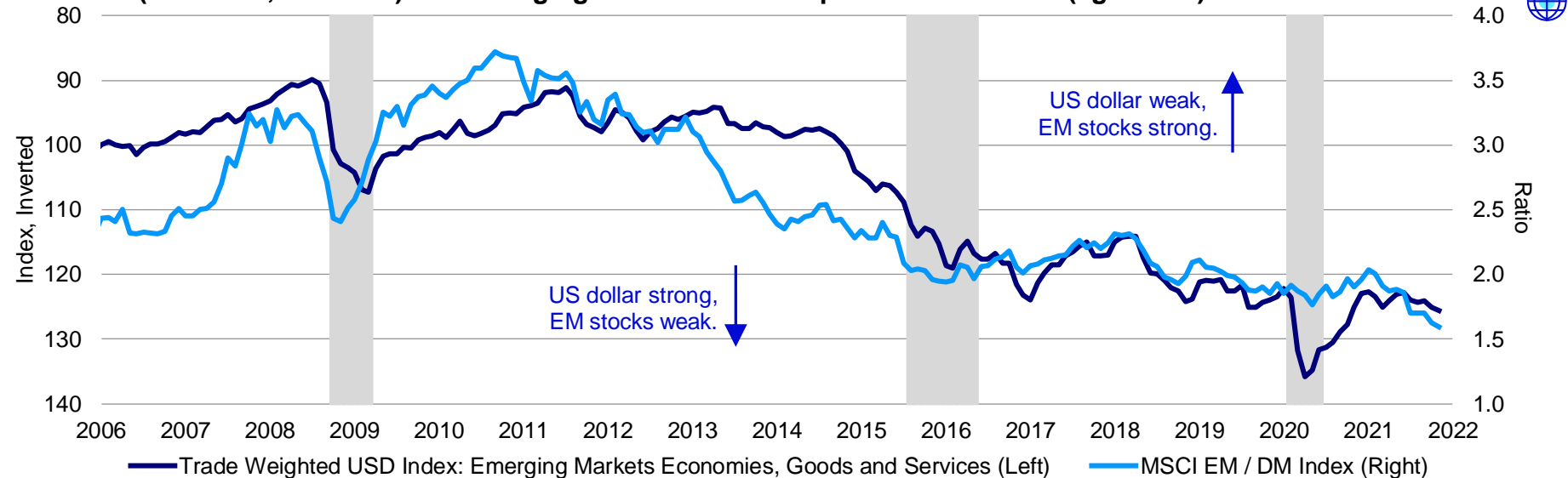
Sources: Bloomberg L.P., Invesco, 11/30/21. **Notes:** The MSCI Emerging Markets Currency Index reflects the performance of 25 EM currencies relative to the US dollar. The MSCI EM Currency Index sets the weights of each currency equal to the relevant country weight in the MSCI EM Index. MSCI EM Index price returns in US dollars. Shaded areas denote EM all-industry contractions. See page 36 for index definitions. 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. See page 36 for index definitions. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**



Technicals



EM stocks have been
oversold

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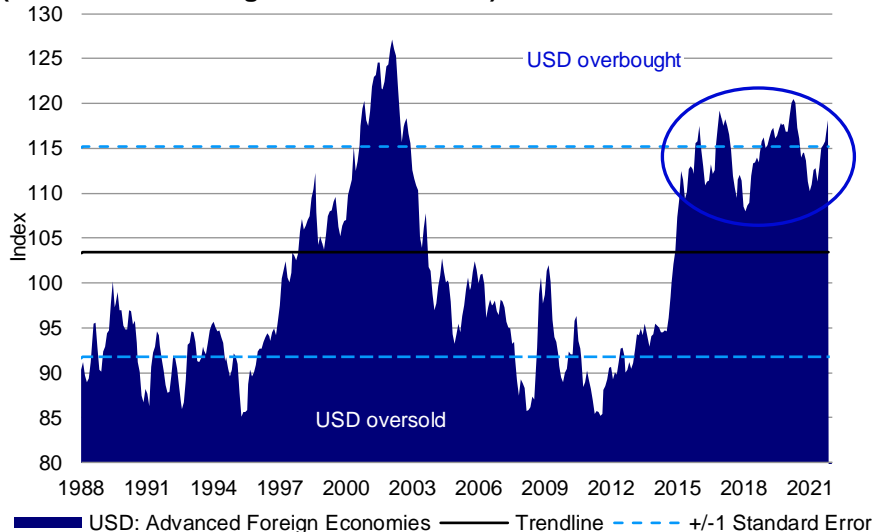
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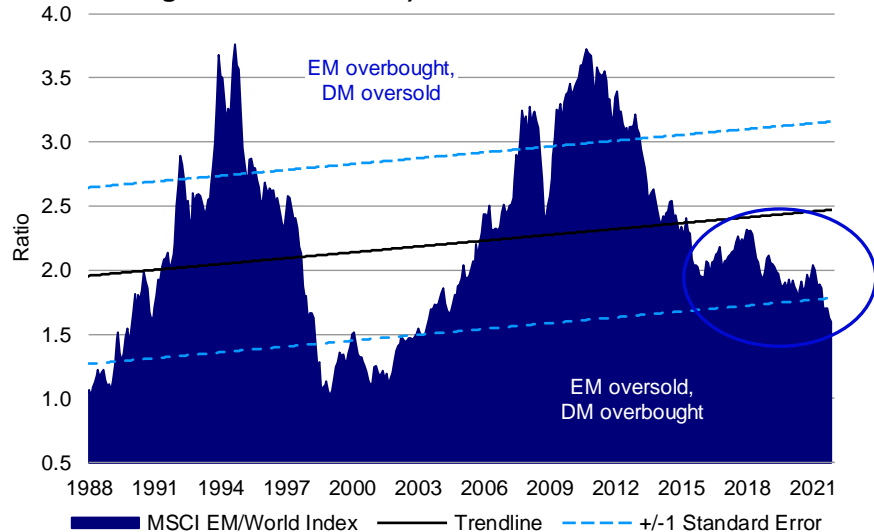
Technicals

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. See page 36 for index definitions. 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).

Definitions

Gross Domestic Product (GDP) is a measure of all the goods and services produced by an economy in a year.

The Commodity Research Bureau (CRB) Bureau of Labor Statistics (BLS) Raw Industrials Sub-Index measures the prices of raw material inputs or products close to the initial production stage.

The MSCI EM Currency Index measures a basket of emerging market currencies against the United States dollar.

The MSCI World Index measures the equity market performance of developed markets and includes the US, Eurozone, Japan and Canada.

The MSCI Emerging Market Index measures the equity market performance of emerging markets.

The MSCI All-Country World Index measures the equity market performance of developed and emerging markets.

The MSCI Indonesia Index, MSCI South Africa Index, MSCI Korea Index, MSCI India Index, MSCI China Index, MSCI Brazil Index, MSCI Taiwan Index, MSCI Russia Index, MSCI Belgium Index, MSCI Norway Index, MSCI Denmark Index, MSCI Sweden Index, MSCI Germany Index, MSCI France Index, MSCI Netherlands Index, MSCI Austria Index, MSCI Finland Index, MSCI Switzerland Index, MSCI Spain Index, MSCI Ireland Index, MSCI United Kingdom Index, MSCI Italy Index, MSCI Portugal Index and MSCI USA Index measure the equity market performance of each respective country.

The Institute for Supply Management (ISM) Composite Purchasing Managers Index (PMI) is a diffusion index that measures US manufacturing and services output.

The ISM Manufacturing PMI is a diffusion index that measures US manufacturing output.

The Emerging Markets Manufacturing PMI is a diffusion index that measures the manufacturing output of developing countries.

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.

The Li Keqiang Index is an alternative measure of Chinese output that is calculated by taking a weighted average of railway cargo volume, electricity consumption and bank loans.

A Composite PMI is a diffusion index that measures the manufacturing and services output of an economy.

A Manufacturing PMI is a diffusion index that measures the manufacturing output of an economy.

Important Information

Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. Past performance does not guarantee future results.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments.

Disclosures

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