

Earnings growth argues for emerging equities

In previous *Daily Themes* (such as *Equities – earnings hold the key, 3rd July*), we touched on the importance of medium-term profit growth when assessing equity markets’ valuations. Today, we delve into the subject in more detail and analyse the latest trends.

In calculating equity market valuations, investors usually look at price-earnings ratios (PEs) and dividend yields. Those indicators are a good starting point. But, when investing in a stock, you are buying the right to a share in a company’s future profits and dividends. So you should consider not only reported earnings but also future earnings growth. You may be willing to pay a high price relative to reported earnings if you expect earnings to soar.

Equity analysts’ expectations for medium-term (three to five years) earnings growth are available for regional and country stock market indices (see below for developed and emerging markets).



Profits growth is intrinsically related to economic activity, and expectations for emerging markets (where trend growth is faster) have always been higher than for developed markets, with medians of 16.3% and 12.2% respectively. That would argue that, even if developed and emerging markets trade on similar forward PEs (as now), emerging markets look more attractive as they should offer better prospects. That is one of the arguments behind our current preference for this sub-asset class.

Carl Astorri
+ 44 20 7753 1612

Jean-Maurice Ladure
+ 44 20 7753 1469

Henry Lancaster
+ 44 20 7957 2426

Analysts expect developed markets’ medium-term profits growth to remain in its structural downward trend, and forecasts have been revised even lower over the past 12 months, as those regions face four structural headwinds: fiscal tightening; muted growth in bank lending; consumer de-leveraging; and greater regulation and state planning of the economy. For emerging markets, too, earnings growth expectations have been revised lower of late but are not in a significant downward trend, and analysts’ expectations have historically been much more volatile than for developed markets, which puts the recent dip in perspective. This volatility (which looks correlated to global activity) may be due to analysts’ difficulties in differentiating between short-term cyclical and long-term structural trends.

Regional medium-term earnings growth			
	Current	Median*	Trend**
Developed Markets	7.8	12.2	10.1
USA	9.3	12.6	11.9
United Kingdom	3.4	9.3	7.4
Europe ex UK	6.6	11.4	7.0
Japan	8.3	13.2	10.8
Pacific ex Japan	3.4	10.1	7.7
Emerging markets	11.9	16.3	15.5
Emerging Asia	12.6	17.0	16.4
Emerging Latam	12.0	15.4	16.2
Emerging Europe	4.8	12.8	10.4

* Historical median since 1995
** Linear regression since 1995 (ex. 18 months during the TMT bubble)
Source: Datastream, Coutts

Getting rid of this cyclical ‘noise’ helps in assessing what is an adjusted assumption for medium-term earnings growth globally (see trend column in the table above). Emerging equities’ earnings are still expected to grow faster than developed (15.5%, versus 10.1%), led by emerging Asia and Latin America (Eastern Europe trails, with only 10.4%). That expectation is partly explained by the very low growth prospects for continental Europe and the UK (both around 7%). Of developed markets, the US still has the best prospects (11.9%), reflecting the economic trend over the past 50 years, with US growth averaging 3.3% a year, versus the UK’s 2.4%.

Issued by Coutts & Co, which is authorised and regulated by the Financial Services Authority. Coutts & Co is registered in England No. 36695. Registered office: 440 Strand, London WC2R 0QS.

The value of investments, and the income from them, can go down as well as up, and you may not recover the amount of your original investment. Past performance should not be taken as a guide to future performance. Where an investment involves exposure to a foreign currency, changes in rates of exchange may cause the value of the investment, and the income from it, to go up or down.

The information in this document is not intended as an offer or solicitation to buy or sell securities or any other investment or banking product, nor does it constitute a personal recommendation. The information is believed to be correct but cannot be guaranteed. Any opinion or forecast constitutes our judgement as at the date of issue and is subject to change without notice. Any Coutts company, or a connected company, its clients and officers may have a position or engage in transactions in any of the securities mentioned.

The analysis contained in this document has been procured, and may have been acted upon, by Coutts & Co and connected companies for their own purposes, and the results are being made available to you on this understanding. To the extent permitted by law and without being inconsistent with any applicable regulation, neither Coutts & Co nor any connected company accepts responsibility for any direct or indirect or consequential loss suffered by you or any other person as a result of your acting, or deciding not to act, in reliance upon such analysis.

Not all products and services offered by the individual Coutts companies are available in all jurisdictions, and some products and services may be available only through particular Coutts companies.

None of the overseas Coutts companies or offices is an Authorised Person subject to the rules and regulations made under the Financial Services and Markets Act 2000 for the protection of investors and depositors, and compensation under the Financial Services Compensation Scheme will not be available in respect of business transacted with them.