

Emerging Markets Update: Even After Recent Gains, Plenty of Upside

Marko Dimitrijević, CFA

- *Emerging markets have outperformed developed markets by over 30% year to date*
- *Despite this move, and a potential correction, there is still significant upside*
- *Growth is stronger in emerging markets than in developed markets*
- *Emerging markets are still inexpensive based on P/E, P/B and dividend yield*
- *Capital is returning to emerging markets*
- *Government policy distinctions between emerging and developed markets are disappearing*
- *The risks we saw in November have mitigated*

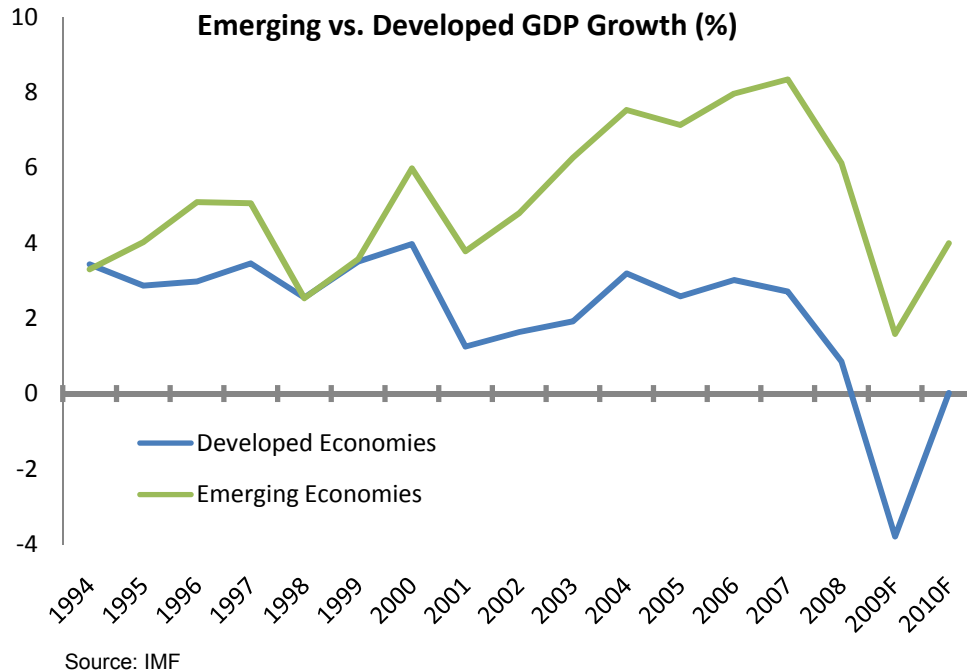
On November 21, 2008 we said that then-current valuations in emerging markets equities offered an attractive entry point in our white paper, [“The Compelling Case for Emerging Markets” \(click for link\)](#). In the six months December 2008 through May 2009, the MSCI Emerging Markets Index rose over 48%. Year to date, emerging markets have significantly outperformed developed markets:

	Jan-May 2009
MSCI Emerging Markets Index	37.5%
MSCI World Index	7.0%
S&P 500 Index	3.0%
Eurostoxx 50	3.6%
Nikkei 225 Index	8.5%

While a short-term correction of the recent strong gains is very possible, the medium- to long-term outlook remains bright, for several reasons.

The emerging markets secular growth story continues

Emerging markets will represent 100% of world growth in 2009 we believe, as emerging economies experienced much less severe recessions than in the developed world. Major economies such as China, India and Indonesia have avoided recession altogether. Domestic demand is now more important than exports to emerging markets' GDP growth, helping to partially insulate emerging markets from the slowdown in demand from developed markets.



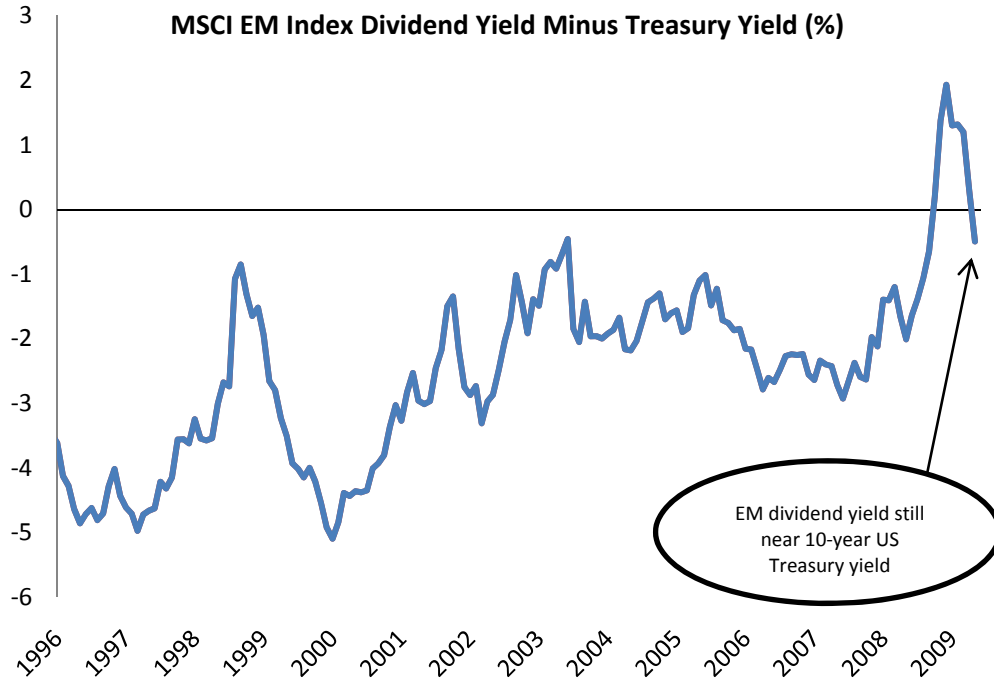
Prudent fiscal and monetary policies have also improved emerging market countries' ability to withstand global macro shocks, reducing historical economic vulnerability and contributing to the resilience that we expect to support a revaluation of equities.

Emerging markets are still attractive based on valuations

Valuations are still compelling by a number of metrics. While above their recent lows as a multiple of earnings, emerging markets are still trading at a 14.7x P/E versus the 16.4x average for the past 15 years.

Another valuation measure, less volatile than earnings, is book value. After falling steeply last year, the price-to-book ratio of emerging markets has rebounded but, like the P/E ratio, is still well below recent peaks and at 1.8x matches its historical average.

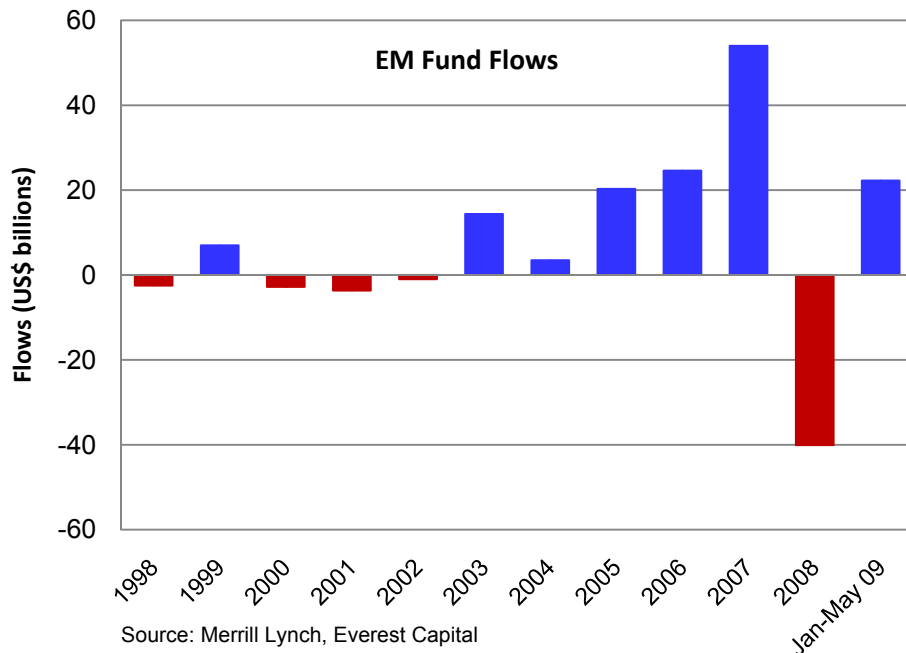
Lastly, because interest rates have been cut sharply by most emerging market central banks, yields on local debt have fallen. Dividend yields of 3% compare favorably to local debt and US Treasuries and continue to support higher equity prices.



Source: MSCI, Bloomberg, Morgan Stanley, Everest Capital

Foreign and especially local investors are returning to emerging markets

Supporting our continued bullish outlook are fund flows into dedicated emerging market equity funds and ETFs. Funds have begun flowing back into emerging markets in recent weeks, with year to date inflows replacing more than half of 2008 redemptions.

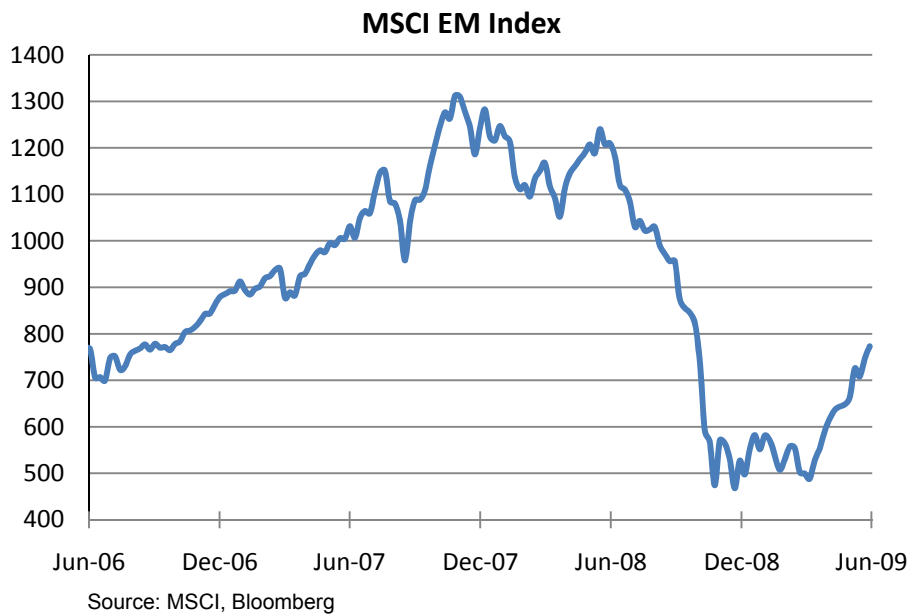


Source: Merrill Lynch, Everest Capital

However, a continued rebound in emerging markets depends only in part on this foreign investment. Local investors are reentering their equity markets with essentially very low cost money from the increased liquidity of stimulus packages and bank lending. Low interest rates also mean that investors with cash are looking to equities, as cash is yielding near zero in real terms in most countries.

Emerging markets equities are still well below their 2007 peak

Even though emerging market equities have had a strong rebound in the past six months, they still trade well below their October 2007 peak (when the MSCI EM Index reached 1338); regaining this peak would reflect a 73% upside from current levels.



Emerging markets should trade at a premium to developed markets based on their growth rates

Because the policy distinctions between emerging and developed markets are disappearing – emerging market policies have become more favorable to free markets and open economies while developed markets have moved the opposite way towards more regulation, more protectionism and more government intervention – emerging markets should trade at least on par with developed markets. However, emerging markets currently still trade at a 19% discount.

Emerging Markets Still Trade at Discount to Developed Markets



Source: MSCI, Bloomberg, Morgan Stanley, Everest Capital

This discount implies a 23% upside to emerging markets based solely on a re-rating of emerging markets to developed market P/E ratios. We believe that given their superior growth rates, emerging markets deserve a premium to developed markets.

The risks we saw in November have mitigated

When we published our November white paper on emerging markets, we highlighted four areas of potential risks to our bullish thesis, each of which has decreased meaningfully in the intervening months:

- *An implosion of the global financial system causing a long-term deterioration in economic growth trends:* It appears the global financial system has been spared.
- *Monetary tightening by the US and within emerging markets:* Any risk of tightening in the near term is remote.
- *Change in government policies globally towards increased protectionism:* Emerging markets governments seem to be turning less protectionist, but developed markets are more so. This increased protectionism in developed markets may negatively affect emerging markets.
- *Heightened geo-political risks:* Relationships between Russia and its neighbors have made fewer headlines, China's relationship with Taiwan has improved, and India had very successful elections.

In our November white paper we concluded by saying:

“We believe that investors who capitalize on the current opportunities in emerging market equities will likely outperform those investing in developed market equities and emerging market debt over the mid- to long term.”

This remains our belief. While a near term correction may interrupt emerging markets equities on their way to doubling from their November 2008 lows, attractive valuations, strong growth prospects and mitigated risks all point to continued compelling medium- to long-term returns in emerging markets. We will have more to say on the blurring distinction between emerging and developed markets in an upcoming publication. Please feel free to contact us if you have any questions or comments, or if we can help you access emerging markets using our proprietary approach.

Everest Capital Limited
65 Front Street, 6th Floor
Hamilton HM 12
Bermuda
Tel: +1-441-292-2200
info@evcap.bm

Everest Capital Inc.
2601 South Bayshore Drive
Suite 1700
Miami, Florida 33133
USA
Tel: +1-305-666-1700
info@evcap.com

Everest Capital Pte Ltd.
61 Robinson Road
#11-01A Robinson Centre
Singapore 068893
Tel: +65-6238-8000
info@evcap.com.sg

Everest Capital S.A.
Route de Genève 7
CH-1291 Commugny/Geneva
Switzerland
Tel: +41-22-789-4000
info@evcap.ch

This report shall not constitute an offer of interests in any fund, which may only be made pursuant to the confidential private offering memorandum, related subscription agreement and applicable laws and regulations. This report is not intended for public use or distribution.

All expressions of opinion included herein are subject to change without notice and are not intended to be a guarantee of future events.

The opinions and data in this report have been obtained from sources believed to be reliable; Everest Capital does not warrant its accuracy or completeness, and accepts no liability for any direct or consequential losses arising from its use.

© Copyright 2009, Everest Capital Limited. All rights reserved. The marks EVEREST CAPITAL and the Everest Capital logos, including THE GLOBAL ALTERNATIVE, are either registered trademarks, or trademarks, of Everest Capital Limited that are protected under the laws of the United States, the United Kingdom, Canada, Hong Kong and other jurisdictions throughout the world.