The Rally in Emerging Markets Not Over Yet

ET Q&A

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For Pramerica International Investments, which has assets under management worth $75 billion, India is among its top overweight markets in Asia and emerging markets due to the prospects of a recovery in earnings and favourable sector mix, says chief investment strategist John Praveen. In an interview to **Sanam Mirchandani**, he says the nervousness in the market over tensions between India and Pakistan would be short-lived if there is no further escalation, as it will not alter the macro picture. Edited excerpts:

Do you expect any prolonged impact on the Indian markets after the surgical strikes across LoC?
If this is an isolated incident and it does not lead to an escalation of tension between the two countries, then the market nervousness would be short-lived. We are looking at India from a long-term perspective. The attractive macro fundamentals and the competitive strength of companies in India does not change.

INDIA VALUATIONS

Valuations are on the expensive side, but if earnings growth improves, the P/E should come down and it will not look that expensive

Given the recent actions by global central banks, do you think the easy money policies will continue?
Markets were a bit disappointed when the ECB in September decided not to extend and expand QE. But I am almost certain that they will extend QE in the December meeting. The Bank of Japan has said it will provide stimulus, but it will steepen the yield curve, which is good for financial institutions. BoJ is also targeting 2% inflation, which will take a very long time, so its stimulus will probably continue for at least a year or so. The big central banks, except the US Fed, are still continuing to provide stimulus, so there is plenty of liquidity and low interest rates. There are questions about the effectiveness of the easy money policies, but if they did not do that, then they may not have had even this much of growth or they could have had another recession in Europe or Japan. However, central banks have cut rates close to zero or even negative, so there is not much room to cut rates. They have also expanded QE, so their balance sheets are expanded.

Will the US Federal Reserve lift rates in December?
The odds of a hike in December are high. By then, the US third quarter GDP number would have come. The two key risks of US elections and Italian referendum would also be over. Emerging markets need not be that concerned about a Fed rate hike as it does not mean the start of a global tightening cycle. We are still in a global easing cycle. If Fed tightens in December, there will be an initial negative reaction, but the markets would eventually adjust.

What would be the impact of the outcome of US elections on emerging markets?
There is a general view that under a (Hillary) Clinton administration, there would be more certainty about policies and that there would be continuation of current policies. If Clinton wins, there won't be a negative reaction due to less uncertainty. Because of uncertainty about policies under Trump, there could be a negative knee-jerk reaction like the reaction after the Brexit vote in June, if there is an unexpected result. But, just like with Brexit, any negative reaction may be short-lived once there is some clarity about Trump's economic team and policies. Investors will also look at the composition of the US Congress, and the "checks & balances" between the executive and the legislature. I don't think there will be a big impact on emerging markets. There may be volatility around the elections, but once that is over, markets will probably stabilise.

What is your view on EMs after the sharp run-up in recent months?
I don't think the rally in emerging markets (EMs) has topped out because the growth outlook for EMs is improving. China is stable in the 6.5-7% range. India is now in the 7-7.5% range and maybe we will see further improvement in India's GDP growth with good monsoon leading to improvement in rural income and spending. The seventh pay commission hike should lead to improvement in urban consumption. If there is more infrastructure spending, we should see further growth. Growth outlook in emerging markets is improving and so the earnings outlook should improve not just in India but in other emerging markets. There is scope for rate cuts in emerging markets, which means that returns from these markets should be very good. Also fund flows into EMs will continue because opportunities in developed markets are somewhat limited, which should also provide support for further gains in the market.


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How is India positioned in the emerging markets universe?
Valuations are slightly on the expensive side, but if earnings growth improves, the P/E should come down and it will not look that expensive. Some of the sectors that are likely to have good earnings recovery would be consumer staples and discretionary and industrial sector. Further, the sector mix of India is very favourable compared to other big markets like China, Brazil, Russia, South Africa and Turkey. In Asia portfolio, our two top over-weights are India and Taiwan. In EMs, we like Brazil, India, Taiwan and Indonesia. We have little exposure to India in the global portfolio but in the Asia portfolio and emerging markets portfolio, we are overweight India.

Do you expect RBI to cut rates?
They will probably do one rate cut before the Fed starts hiking rates in December. By that time, we would have seen more data on inflation. It might be good to do it before the Fed raises rates because after that there may be some volatility in the market.

EASY MONEY

The big central banks, except the US Fed, are still continuing to provide stimulus, so there is plenty of liquidity and low rates

Which sectors do you like in India?
The themes that we are looking at are consumer staples and consumer discretionary mainly because of likely improvement in rural and urban incomes.