EFFICIENT GROUP

ECONOMIC COMMENTARY

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FINANCIAL CRISES AND EMERGING MARKETS

Shortly after the turn of the century, following the Asian financial crisis in 1997-1998 and the dot-com bubble burst in 2000-2002, investor sentiment swung increasingly in favour of emerging markets. China was the main driving force, growing at an average rate of about 10% annually between 1990 and 2000, and almost reaching an 11% annual growth rate between 2001 and 2007-2008. But other emerging economies, like India, also played an important role. Overall, between 2000 and 2007-2008, emerging countries were supported by strong economic activity, globalisation and trade liberalisation, commodity booms, financial market reforms, low interest rates, and a demographic dividend, which caused investors to pour capital into their markets. In 2008, with the start of the global financial crisis, everything changed, and the rich world experienced almost 12 years of unprecedented growth, returns, and positive sentiment.

After the mentioned crises, investors were scared and pulled their liquid assets from the risky havens of emerging markets, which not only weighed on emerging market currencies but also on their capital markets. At the same time, the rich (developed) countries started the largest monetary stimulus that the world had ever seen, something emerging countries were not able to do. Not only that, but most of the rich world governments stepped in with fiscal stimulus too, which was also not something emerging markets could do. The result was that investor sentiment swung increasingly in favour of the developed world, and their capital markets and currencies enjoyed unparalleled inflows and returns. Of all the developed countries no one was favoured more than the United States. Not only did they own the global reserve currency but they also had the most sought-after listed companies (technology companies that had free cash flow and needed almost no physical assets), and their risk- and inflation-adjusted bond returns were often the highest in the world.

In 2020, ripe for another global recession which could have shifted sentiment back to emerging countries, COVID-19 intervened. Once again, it was the rich world with almost unlimited supplies of monetary and fiscal support that came out on top. Put differently, rich countries have been keeping their markets alive for longer. But also artificially inflated for almost 15 years. All the while governments in many emerging countries, who cannot print unlimited amounts of money and artificially inflate their markets, have been fighting to enforce structural reforms. Companies in these poor countries have been persistently producing profits without seeing it reflected in their valuations. Investors were simply unwilling to invest in emerging markets whilst enjoying artificially inflated returns in the developed markets that were perceived to be less risky. In this context, it is easier to understand why we have not seen the rand appreciate or the Johannesburg Stock Exchange take flight as it did decades before the 2007-2008 global financial crisis.

But even before the global financial crisis, this swing in sentiment between the emerging world and the rich world has occurred many times over and will continue to do so in the future. It is, however, worthwhile to consider that the length of the cycles might have changed. For this reason, we still maintain that as the rich world is weaned from its stimulants, the rich world will slow down and returns will normalise. In the end, and it can be another five to ten years, sentiment will be forced towards the riskier havens of emerging markets. This, in turn, will result in a substantial appreciation of emerging market currencies and unprecedented returns on their capital markets; the annual double-digit returns we last had before the 2007-2008 global financial crisis.

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