Pradeep Chokhani
General Partner -
India Mount Hill Investment
Advisors (P.) Ltd.

Developed *v.* Developing Countries - Where to invest?

By following some interesting tips in this short but informative write-up, one can take a right decision in respect of investment in developed or developing countries.

Introduction

1. Investors have been plagued with a serious question on where to invest given that global issue which started in the US has now spread to Europe with the PIIGS (Portugal, Ireland, Italy, Greece and Spain) developing cracks in their economies. Emerging markets which have been in the fore-frontiers of global investors with China leading the pack, have been in focus once again for foreign investments.

A key differentiation

2. We look at the key differentiation between both sides of the world whether developed nations are really worth the salt and emerging markets which are over-heated whether they are still good for investors looking at same rate of returns as in the past:

EMERGING	DEVELOPED
High GDP growth of more than 6 per cent, but is overheated	GDP growth rate of less than 3 per cent
Inflationary pressures are high	Fall has stopped but recovery expected to be long in US. Sharp fall in prices has led to increase in volumes. Home sales in US have shown signs of pickup. European countries are going through the rounds of US recent past and prices are still falling.
Rising interest rates	Key concerns are looming. European countries have high public debt *v.* GDP with sovereign default looming large
Moderate corporate earnings growth despite higher GDP growth	Valuations would improve sharply but recovery expected to be long

Greece crisis...

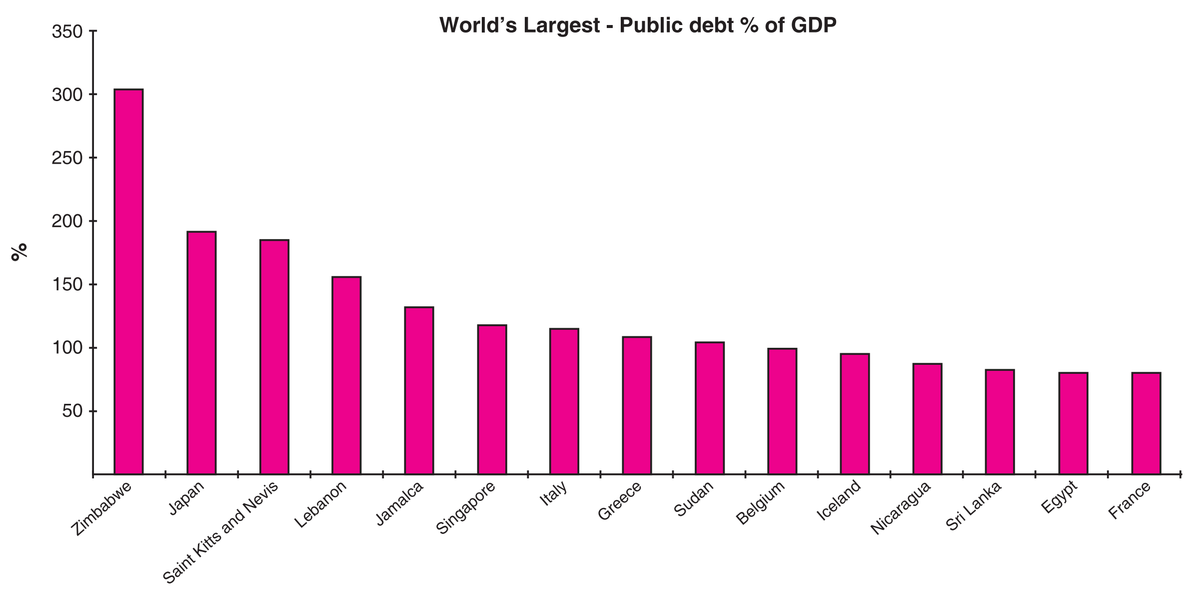
Is a no wonder given that the sub-prime impact starting with US is now spreading to European Union. High borrowings as compared to GDP have led to many countries defaulting in the re-payment. Dubai re-payment is a past. People and more specifically investors have a short memory. Russia, in the past, had to re-schedule its repayments for products imported in that country. Indian exporters were no different. Many large pharmaceutical companies, *i.e.*, Dr. Reddy's and the likes who exported to Russia got re-scheduled repayments which were supported by the Government. The difference between Russia and the current situation is that it's only a group of countries developing cracks with over-leveraging over a single country in the past.

Greece Government is putting things together and has reported that they would be raising taxes and reducing expenses by apprx. US$7bn. Though it is difficult to predict the timings of Greece bailout package, yet many European countries having high public debt over their GDP are shaking Europe and its common currency, Euro. The debt burden is so huge in Europe that nearly there is a trillion dollars need this year to re-finance debt.

...with other countries waiting-in for default!

It all started with banks, *i.e.,* Bear Stearns, Lehman Brothers, etc. Fiscal policies in other European countries are no good. Spain is facing high budgetary deficit of more than 10 per cent to its GDP and has high unemployment rate. Ireland did a bit of tightening with hiring freeze and wage cuts in the Government departments and raised apprx. Euro20bn. this year. Portugal has more dependence on foreign investors due to its shortages on savings circulation in the economy.

All of the above would have an impact on the Euro with financial institutions throwing darts, expecting a drop in Euro and sterling. Though Greece is important, yet it is imperative that other European countries having high debt would be the focus henceforth.



Source: IMF, CIA - world fact handbook

Investing in India

3. Foreign investments, which drove Indian stock markets to new heights, started in the financial year 2003 and onwards. Roads and highways were the crucial drivers to the overall economy. Mother feeder sectors such as steel and cement drove demand for ancillary sectors. The key main drivers were the highly-densely city-centric trench of people travelling out of main cities which drove demand for sectors such as consumer durables, paints, automobiles and real estates. The local index rose by 4 times during the financial year 2004-08. Small and mid-caps rose much more with new companies being listed locally and large business groups raised huge sums from overseas investors.

However, this is the past. With emerging markets still the favourite of global investors, India forming part of BRIC nations is looking at a stable 15 per cent YoY earnings growth in FY11 for BSE-30 companies. Despite inflation a worry in India with fiscal deficit still remaining a key question, visibility of earnings growth going forward would be the key driver to a stable flow of foreign investments into India.

Conclusion

4. We look at the overall emerging markets to view specific opportunities and think that fewer funds would flow to emerging markets than in the past due to high inflationary pressures build-up which is overheating these markets. Hence, funds would move back to developed markets in properties and stocks while emerging markets would remain stronger in sectors such as gold and commodities. A larger impact of these in terms of timings would be seen only in the long-run. The fall has stopped in the US and home sales have shown signs of pick-up. Prices in European countries have started to see sharp fall and are expected to go through the same rounds of US recent past.

Oil prices would go up from hereon due to higher demand coming from emerging markets for capacity expansions. This price increase would put pressure on margins in emerging markets which are generally net importers (including Oil) and, thus, earnings growth is expected to be moderate.

Key sectors which would do well in emerging markets are metals given Iron-Ore mine bank and cheaper cost of manufacturing would enable Asian markets become the Metals Hub for developed countries and to some extent it has already.

IT and Pharmaceuticals are other two sectors which would do very well out of emerging markets and particularly IT companies out of Asia would be the driving force to key sectors needed to drive growth in developed countries. Pharmaceutical manufacturing would be Asia focused while R&D coming in from developed countries would drive earnings growth for MNC pharmaceutical companies. Marketing and distribution would be the key drivers for local markets in Asia Pacific.