Stronger Growth from Emerging or Developed Markets Ahead?

November 22, 2016

William Blair Economist Olga Bitel considers what drives returns in both emerging and developed markets, examining the effect market offerings and rising affluence may have. Watch the video or read the recap below.

Economic growth in emerging economies has outpaced growth in developed economies in the last decade, although the gap has been narrowing. Will this trend continue over the next 10 years, or will developed economies become the new growth engine? And does this really matter for investment returns?

Bitel: Indeed, aggregate growth rates matter little for financial markets returns, whether in equities, fixed income, or real estate. Instead, changes in market offerings and affluence drive returns and at the same time imply great variability in growth rates across industries and companies.

Department stores provide a timely illustration of how market offerings drive similar—poor—returns across markets with vastly different growth rates, such as the United States and China. U.S. retail sales have been growing at an annual rate of between 2% and 3% for the past two years. Yet U.S. department stores continue to report declining top lines and shrinking margins, while internet retailing is growing at a double-digit pace.

China's retailers are afflicted with exactly the same phenomenon. E-commerce in China has been growing at 45%

per year for at least five years. During this time, retail sales volume growth at large companies more than halved. So we see the two largest economies –one developed, one emerging. Retail sales are growing at 2% annually in one, and four times faster in the other.

Yet department stores face similar declining fortunes in both countries, as internet retailing changes market offerings. Rising affluence in China may also radically alter consumption patterns.

Staying in China, if we assume that growth slows to 3.5% annually by 2025, the number of affluent households will double to approximately 180 million, fueling rapid expansion in sales of SUVs, foreign travel, various forms of entertainment, and affordable luxuries such as chocolate and coffee.

The flip side is that lower-income households will grow more slowly, bringing down the growth rates of the goods this group favors. Sales of key consumer products for this income bracket, such as microwave ovens and soft drinks, have already slowed markedly.

With many trade and capital barriers having been dismantled already, companies shaping and servicing consumer preferences may be domiciled anywhere in the world.

Disclosure:

This content is for informational and educational purposes only and not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines, and restrictions.

Information and opinions expressed are those of the authors and may not reflect the opinions of other investment teams within William Blair Investment Management, LLC, or affiliates. Factual information has been taken from sources we believe to be reliable, but its accuracy, completeness or interpretation cannot be guaranteed. Information is current as of the date appearing in this material only and subject to change without notice. Statements concerning financial market trends are based on current market conditions, which will fluctuate. This material may include estimates, outlooks, projections, and other forward-looking statements. Due to a variety of factors, actual events may differ significantly from those presented.

Investing involves risks, including the possible loss of principal. Equity securities may decline in value due to both real and perceived general market, economic, and industry conditions. The securities of smaller companies may be more volatile and less liquid than securities of larger companies. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks. These risks may be enhanced in emerging markets. Different investment styles may shift in and out of favor depending on market conditions. Individual securities may not perform as expected or a strategy used by the Adviser may fail to produce its intended result.

Investing in the bond market is subject to certain risks including market, interest rate, issuer, credit, and inflation risk. Rising interest rates generally cause bond prices to fall. High-yield, lower-rated, securities involve greater risk than higher-rated securities. Sovereign debt securities are subject to the risk that an entity may delay or refuse to pay interest or principal on its sovereign debt because of cash flow problems, insufficient foreign reserves, or political or other considerations. Derivatives may involve certain risks such as counterparty, liquidity, interest rate, market, credit, management, and the risk that a position could not be closed when most advantageous. Currency transactions are affected by fluctuations in exchange rates; currency exchange rates may fluctuate significantly over short periods of time. Diversification does not ensure against loss.

There can be no assurance that investment objectives will be met. Any investment or strategy mentioned herein may not be appropriate for every investor. References to specific companies are for illustrative purposes only and should not be construed as investment advice or a recommendation to buy or sell any security. Past performance is not indicative of future returns.