“TO HAVE AND HAVE NOT”[i]
Are “Have Not” Countries Really Emerging?

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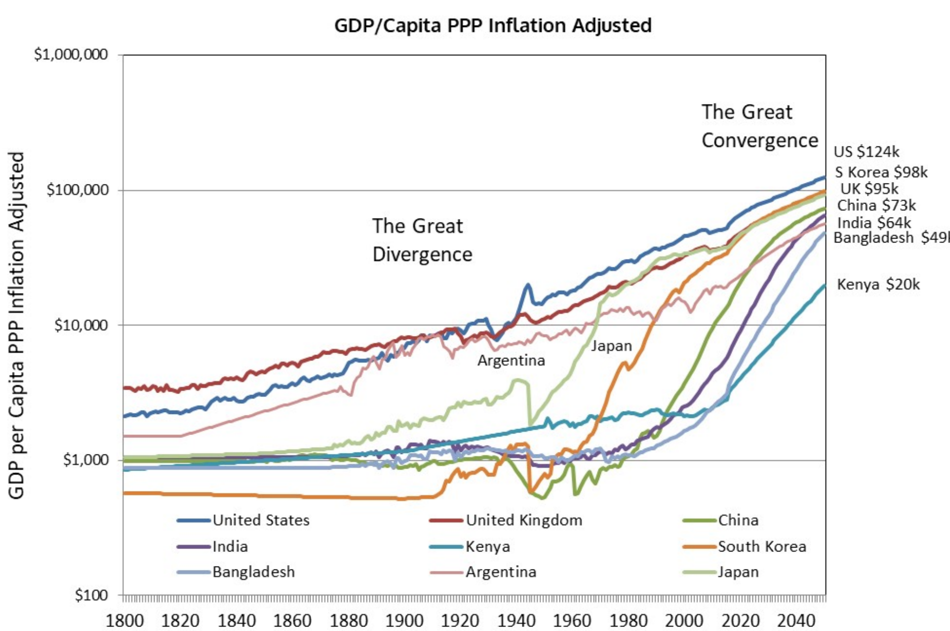
By Larry Speidell

“Future Billionaire”, a tro tro in Pokuase, Ghana[ii]

The developing world has improved in many ways since the 1970s. Africa achieved independence. China opened up and reformed. The Soviet Union collapsed into 15 republics. Russia opened up and did not reform…

Meanwhile, stock markets burgeoned in the developing world, with much of the progress thanks to the International Finance Corporation (IFC). In 1981, IFC’s Antoine van Agtmael felt that *“Third World”* was a term that connoted extreme poverty, shoddy goods, and hopelessness to many at the time, but *“Emerging Markets”* suggested progress, uplift, and dynamism[iii]. Now, 40 years later, emerging markets are a popular asset class, but it is time to check on them and the other developing markets, to see which ones have truly emerged and which have not – which are the “haves” and which are the “have nots”.

In the 19th century, after centuries of little global progress in economic terms and standards of living, the industrial revolution began leading to a great divergence of relative prosperity, shown in the GDP/capita chart at the right.



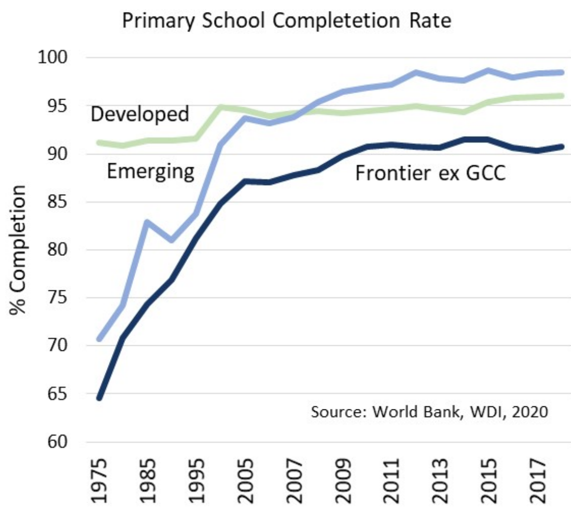
Source: Gapminder, 2018, .gapminder.org/data/, Outlook/gdp_per_capita

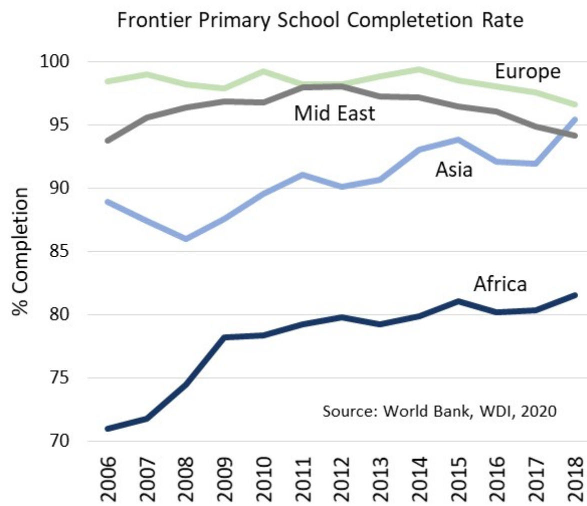
During most of the past 150 years, rich countries had advantages in educated labor, advanced technology, access to raw materials and capital. Now, however, the education gap in labor has narrowed; capital flows more quickly across borders; technology is soon transferred (or copied) and raw materials have become a smaller component of the value of finished products.[iv] Today, it is easier for poor countries to imitate and catch up than it is for many rich countries to innovate.

Measures of Progress

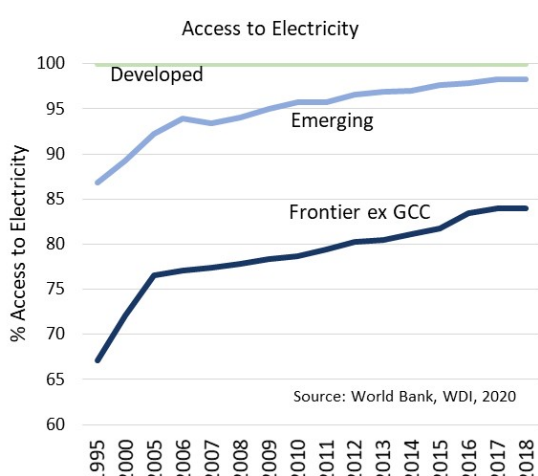
By several measures, the developing world has made huge progress in the recent decades, as was highlighted by Hans Rosling in Factfulness.[v]

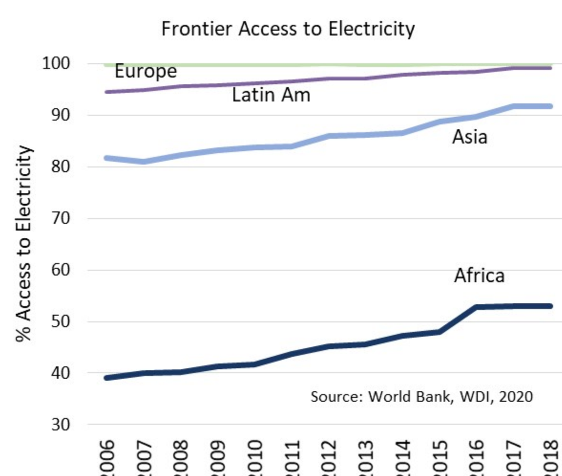
Primary school completion rates, for example, have made dramatic gains in the developing world[vi]. And when we drill down into the frontier regions, Africa has gone from an average of 71% primary school completion in 2006 to 82% in 2018. Rwanda has gone from 25% to 87%, Cote d'Ivoire from 44% to 72%, Malawi from 60% to 80%. There is still a long way to go, but the trend is encouraging.





Access to electricity is another measure of progress. I recall three boxcar-sized generators in the courtyard of the Golden Tulip Hotel in Accra, Ghana, in 2007. They started up nearly every hour to keep the hotel's lights on when the power grid failed. Yet today, Ghana is an exporter of electricity. Since 2006, the percent access to electricity in the frontier has risen from 74% to 86%, and this progress has been especially strong in frontier Africa, which has gone from 39% to 53%. The job is not done, but for many countries, it is like the difference between night and day: Kenya from 28% in 2006 to 64% in 2018; Tanzania 14% to 33%; Rwanda 11% to 34%. And the gains haven't been too shabby in Asia: Bangladesh from 51% to 88%; Sri Lanka 79% to 98%.

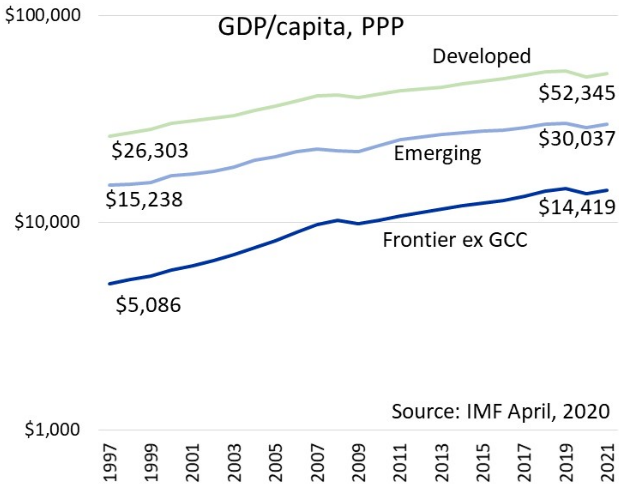


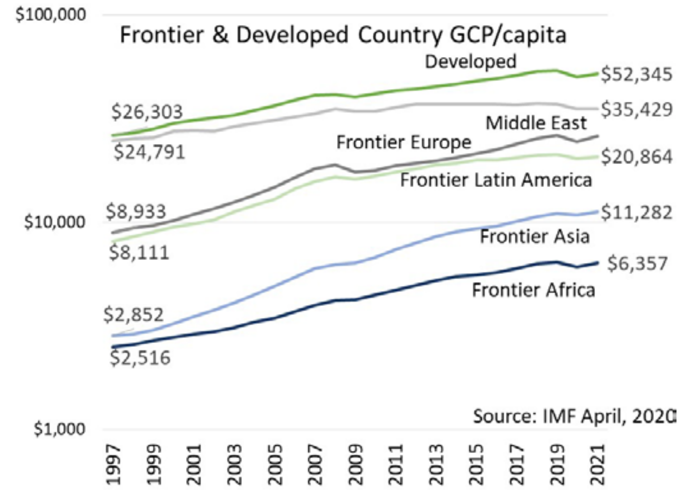


What about income per capita?

What developing countries want is not the dry metrics of electricity or education. What they really want is to attain the standard of living that developed countries take for granted. The IMF April 2020 World Economic Outlook presents data on GDP per capita on a purchasing power parity (PPP) basis from 1997 through its projections for 2021 (this is a shorter forecast than the IMF's usual four-year horizon due to COVID uncertainty). I used the data to calculate the annual average GDP/capita of developed countries, which is a moving target, rising over time. We can then see which countries are the "haves", where the gap of their GCP/capita versus the developed world has narrowed, and which are the "have nots", where the gap has been flat or widened.

Since 1997, there has been progress in this measure of relative economic wellbeing in many countries, but not in terms of the average income of countries in the MSCI Emerging Markets Index (MSCI EM). It





was 57.9% of the average of developed countries in 1997, and it is expected to be 57.5% in 2021. Meanwhile, frontier markets ex GCC (excluding the rich oil producing countries of the Middle East Gulf Cooperation Council) have risen from 19.6% of the developed country level in 1997 to an expected 27.5% in 2021.

Within frontier markets, Asia has improved the most, while the Middle East GCC countries have lagged, after starting from a high base.

At the right are the 25 countries that have improved the most from 1997 to 2021.

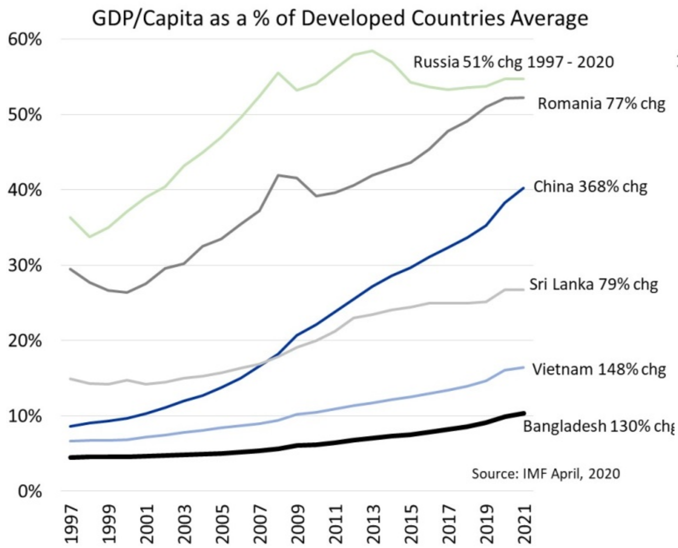
Six of these are in the MSCI Emerging Markets Index, with China leading the list, going from GDP/capita 8.6% of the developed country average in 1997 to 40.2% by 2021. China gained from $2,262 GDP/capita to $21,049 while the developed country average grew from $26,303 to $52,345. Meanwhile, India has

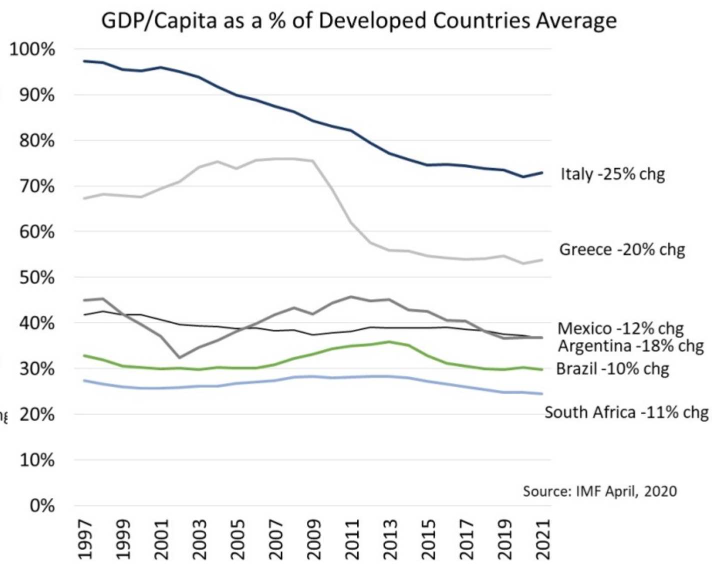
Progress 1997 - 2021		1997 % of Developed Avg	2021 % of Developed Avg	% Chg 1997 - 2021
Emerging	China	8.6%	40.2%	368%
Frontier Asia	Cambodia	3.3%	8.9%	172%
Frontier Europe	Georgia	8.7%	22.8%	162%
Emerging	India	6.5%	16.5%	154%
Frontier Asia	Vietnam	6.6%	16.4%	148%
Frontier Asia	Bangladesh	4.5%	10.3%	130%
Frontier Europe	Lithuania	31.1%	69.5%	124%
Frontier Europe	Latvia	27.3%	58.2%	113%
Frontier Asia	Kazakhstan	25.4%	53.9%	112%
Frontier Asia	Mongolia	13.2%	27.3%	107%
Frontier Europe	Bulgaria	24.7%	47.4%	92%
Frontier Africa	Rwanda	2.7%	5.0%	83%
Frontier Asia	Sri Lanka	14.9%	26.7%	79%
Frontier Europe	Romania	29.5%	52.2%	77%
Frontier Africa	Mozambique	1.4%	2.5%	77%
Frontier Europe	Estonia	38.4%	67.7%	76%
Emerging	Poland	36.6%	63.4%	73%
Frontier Latin A	Panama	28.3%	49.0%	73%
Developed	Ireland	92.4%	153.7%	66%
Frontier Africa	Mauritius	28.8%	46.2%	61%
Emerging	South Korea	54.7%	85.9%	57%
Frontier Africa	Ghana	8.5%	13.4%	57%
Frontier Africa	Tanzania	4.2%	6.5%	55%
Emerging	Philippines	12.1%	18.7%	55%
Emerging	Taiwan	68.0%	103.3%	52%

Source: IMF, World Bank, 2020

improved from 6.5% to 16.5% ($1,706 to $8,619).

Ireland is a developed country, but it's in the top 25 list, having moved from 92.4% of the developed country average to 153.7% of it. Meanwhile, 18 of the top 25 countries are in the frontier, led by Cambodia, Georgia, Vietnam and Bangladesh.





The above left chart above shows some of the greatest gainers, with labels that show the percent change in GDP/capita as a percent of the developed country average level from 1997 to 2021. For example, Romania has risen by 77%, from 30% of the developed country level in 1997 to 52% in 2021. On the other hand, Russia made a strong start, going from 36% of the developed country average in 1997 to 56% in 2008 but has stagnated since then.

Meanwhile, a number of countries have declined on a relative basis, as shown in the chart above right and in the table at the right, which shows the 25 countries that have lost the most ground.

Mexico, Argentina, Brazil and South Africa are among the eight emerging countries that have fallen in their GDP/capita as a percent of the developed country average, The list also includes GCC countries such as Saudi Arabia and the UAE that started off very rich and are relatively less rich today. Greece

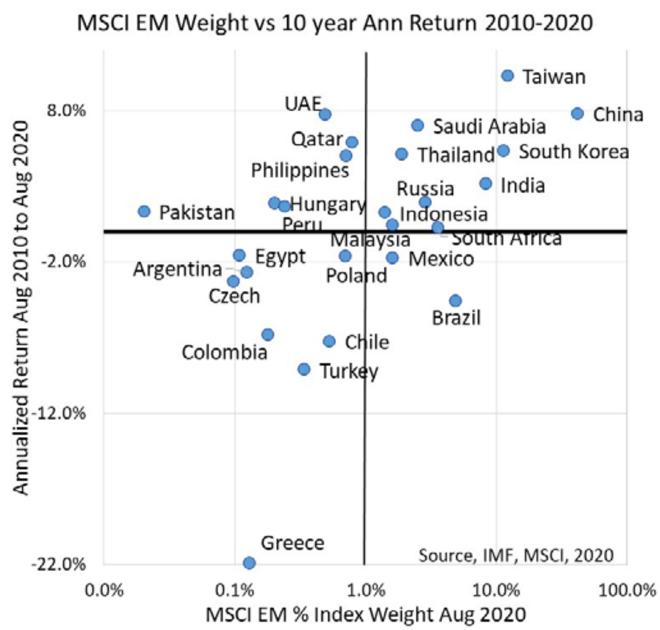
Declines 1997 - 2021		1997 % of Developed Avg	2021 % of Developed Avg	% Chg 1997 - 2021
Emerging	UAE	308.1%	122.0%	-60%
Frontier Africa	Zimbabwe	9.6%	4.6%	-51%
Middle East	Lebanon	36.6%	23.2%	-37%
Middle East	Kuwait	176.6%	120.8%	-32%
Middle East	Oman	114.3%	84.1%	-26%
Frontier Latin A	Jamaica	24.3%	17.9%	-26%
Developed	Italy	97.3%	72.9%	-25%
Middle East	Bahrain	123.0%	92.7%	-25%
Emerging	Saudi Arabia	129.6%	101.2%	-22%
Emerging	Greece	67.3%	53.8%	-20%
Emerging	Argentina	44.9%	36.7%	-18%
Middle East	Jordan	20.7%	17.6%	-15%
Developed	Norway	159.5%	136.2%	-15%
Developed	Japan	97.0%	83.9%	-14%
Emerging	Qatar	282.4%	244.7%	-13%
Emerging	Mexico	41.7%	36.6%	-12%
Emerging	South Africa	27.4%	24.4%	-11%
Developed	Switzerland	132.4%	118.6%	-10%
Emerging	Brazil	32.9%	29.8%	-10%
Developed	Denmark	110.0%	99.7%	-9%
Developed	France	93.9%	85.6%	-9%
Developed	Portugal	67.0%	61.3%	-8%
Developed	Belgium	98.0%	89.7%	-8%
Developed	Canada	96.7%	90.7%	-6%
Developed	Austria	101.8%	96.4%	-5%

Source: IMF, World Bank, 2020

started the period in the MSCI Developed country index but was lowered to MSCI EM in 2013.

Seven frontier countries are on the list of losers, including Zimbabwe and Lebanon. And among the nine developed countries, Italy has lost the most percentagewise.

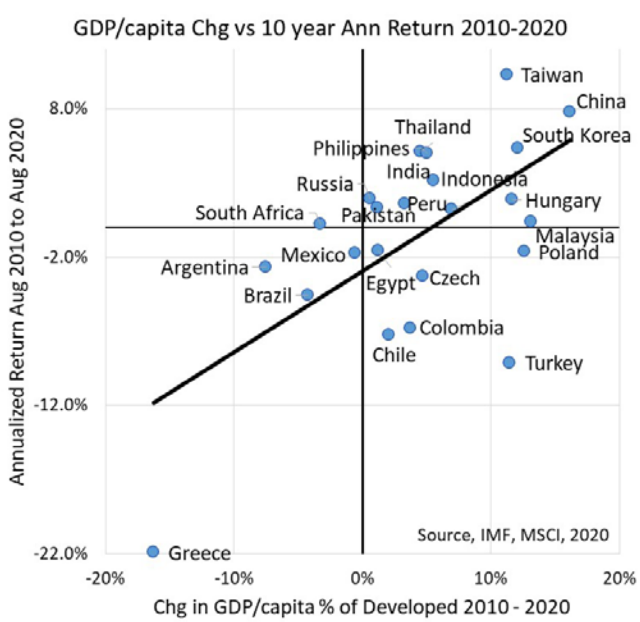
Progress versus Returns



Countries covet inclusion in the MSCI Emerging Markets Index and view it as a sign of progress. Yet that designation is no ticket to prosperity or financial returns.

Sadly, countries that have been elevated from frontier market status are often ignored by emerging market investors, as are the other small emerging markets. The scatter chart at the right compares current country weights in in the MSCI Emerging Market Index (MSCI EM) with past ten-year returns. Of the fourteen countries with index weights below 1% in MSCI EM, eight had negative returns from 2010 to 2020. On the other hand, only two of the twelve larger countries had negative returns.

The difference between the "haves" and the "have nots" is illustrated in the next chart (below left) which shows a general relationship between economic progress relative to the developed world and market returns.



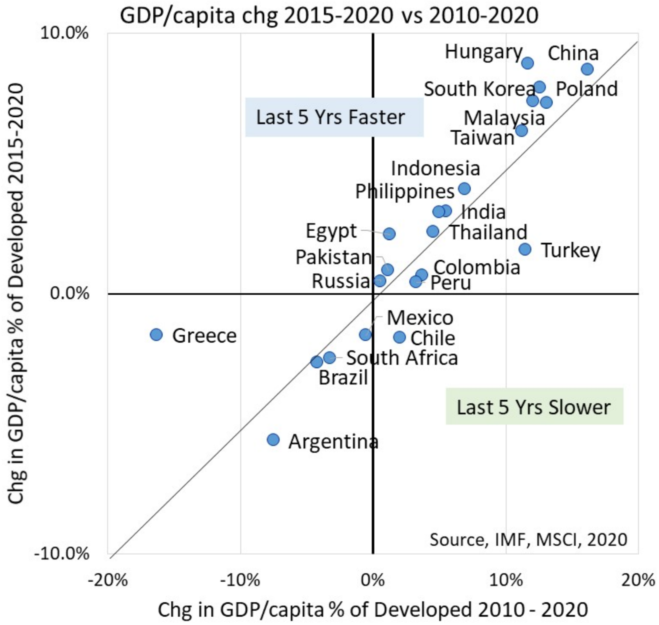
This chart excludes the special cases of GCC countries because their declines from ultra-rich status to merely very rich don't relate to market returns as much as to the price of oil. Furthermore, it is difficult to call them "emerging", given that their incomes are higher than those in much of the developed world.

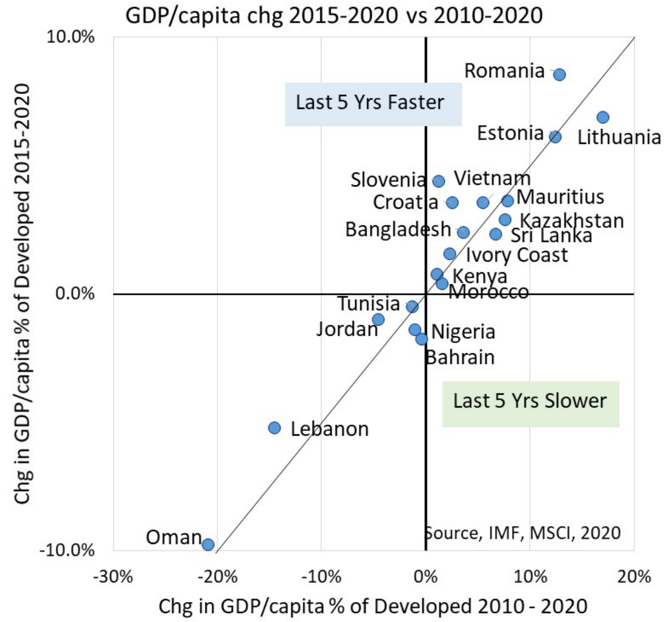
Of the remaining 23 countries, the data show several that have not "emerged" and were in the table above.

Five countries have declined in GDP/capita relative to the developed world, and they have had lackluster returns: Greece, Argentina, Brazil, Mexico and South Africa. These countries total 10% of MSCI EM, and if we add Russia, that has gained only 0.6% in relative GDP/capita over the ten years, the total comes to 13%. Thus, three of the five BRICS have failed to fulfill their promise as "emerging markets".

Furthermore, the game is not over. Some countries are gaining momentum, while others are losing steam. The next set of charts shows the most recent five-year gains in relative GDP/capita for each emerging and frontier country versus its 10-year average gain. Countries of greatest interest are those that are in the top right quadrant and are also above the diagonal line, recent five-year growth rate is higher than the long term.

On this basis, fourteen countries in MSCI EM are doing well overall and especially in the recent five years: China, Taiwan, South Korea, India, Malaysia, Philippines, Thailand, Indonesia, Poland, Hungary and Egypt. Meanwhile, disappointing countries include Argentina, Mexico, Brazil, Chile, Colombia, Peru, South Africa and Turkey.



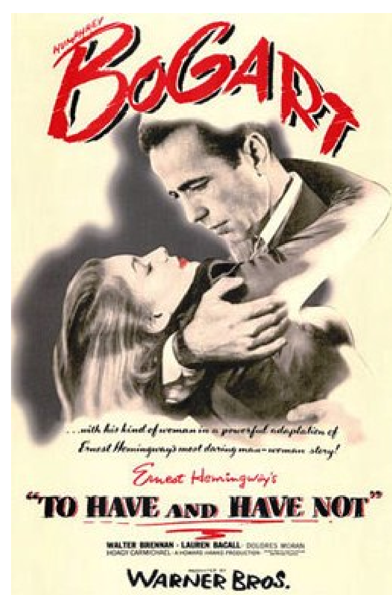


Among the frontier countries, Romania, Croatia, Slovenia, Vietnam and Bangladesh have done well while Nigeria has been disappointing.

TO HAVE AND HAVE NOT

Humphrey Bogart & Lauren Bacall, 1944[vii]

"Johnson: What sort of a day will it be?
Harry Morgan: I don't know. Just about like yesterday. Only better."
– Humphrey Bogart, Captain Morgan



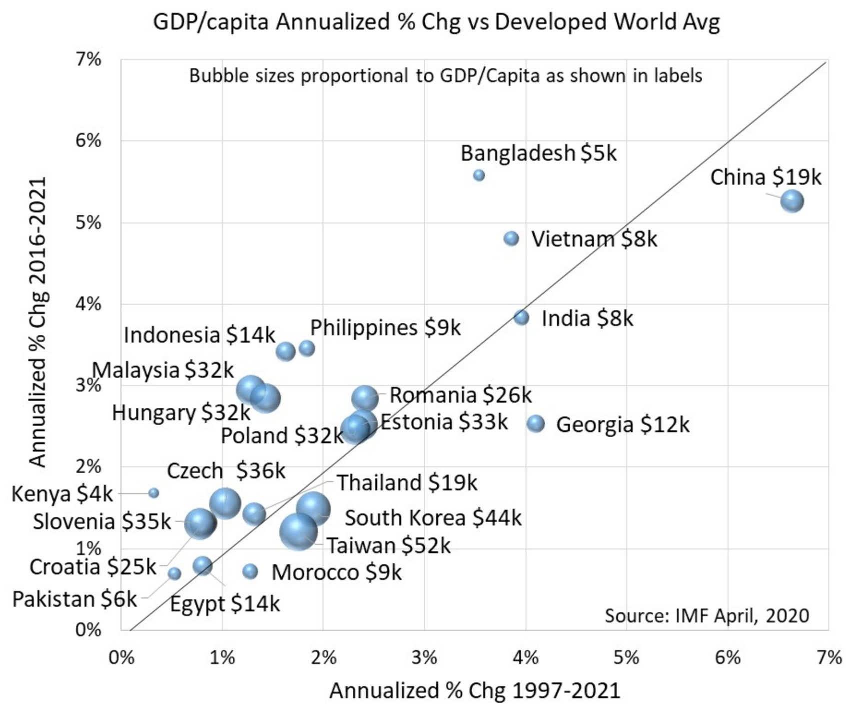
So which are the countries outside of the developed world where today has a good chance of being better than yesterday?

To build a better developing market universe, one that is founded on opportunity rather than size, I looked at progress in closing the gap of GDP/capita with the developed world.

I found 22 countries with good progress in both the past five years and the period since 1997. My list has 13 countries from MSCI EM, five from frontier Europe, two from frontier Asia and two from frontier Africa (I placed Estonia alone in the list for simplicity, but it should include the Baltic neighbors, Latvia and Lithuania).

The data points in the scatter chart below are sized by GDP/capita and show a bias in growth rates in favor of the poorer countries, partly because they started from a lower base.

Noticeably missing from this list are countries in the MSCI EM Index that are stagnating rather than emerging, such as Mexico, Brazil, Argentina, Turkey, South Africa and Russia, plus the GCC.



In all of this, however, I am making three big assumptions:

1) Recent winners will not fail.
2) Recent failures will not reform.
3) Markets have not already discounted the prospects of each country.

Indeed, there have been major turning points in countries, such as the China's reforms under Deng Xiaoping in the early 1980s, Vietnam's Đổi Mới opening in the late 1980s and India's liberalization in the early 1990s. Still, these have been the unicorns. I believe that for most countries trends in place will continue.

And as for valuation, I found only a small positive relationship between ten-year progress in GDP/capita and PEs based on 2020 estimates from FactSet. The r-squared was 0.008. If I remove Lithuania and Estonia, with PEs of 34x and 24x, the slope of the trend line across the other countries turns negative, with greater progress being related to lower PEs.

Conclusion

What does all this say about the hypothesis of emerging market investing?

1) A catchy name is no guaranty of actual progress in terms of "emergence".
2) Some developing countries have done a much better job of delivering progress to their people and investors than others.

I believe that this is a good time to move away from the "emerging market" brand and towards a broad-based approach, building a diversified portfolio that focuses on those developing markets that stand the best chance of being the "haves" of tomorrow, shown in the table below.

The "Haves" of Tomorrow		Annualized Relative GDP/capita % Chg 1997 -2021	Annualized Relative GCP/capita % Chg 2016 -2021	2020 GDP/Cap
Frontier Asia	Bangladesh	3.5%	5.6%	$4,992
Emerging	China	6.6%	5.3%	$19,326
Frontier Asia	Vietnam	3.9%	4.8%	$8,101
Emerging	India	4.0%	3.8%	$8,129
Emerging	Philippines	1.8%	3.5%	$9,237
Emerging	Indonesia	1.6%	3.4%	$13,687
Emerging	Malaysia	1.3%	3.0%	$31,513
Emerging	Hungary	1.4%	2.8%	$32,481
Frontier Europe	Romania	2.4%	2.8%	$26,321
Frontier Europe	Georgia	4.1%	2.5%	$11,617
Frontier Europe	Estonia	2.4%	2.5%	$32,877
Emerging	Poland	2.3%	2.5%	$31,813
Frontier Africa	Kenya	0.3%	1.7%	$3,743
Emerging	Czech Republic	1.0%	1.6%	$35,625
Emerging	South Korea	1.9%	1.5%	$43,503
Emerging	Thailand	1.3%	1.4%	$18,556
Frontier Europe	Croatia	0.8%	1.3%	$24,897
Frontier Europe	Slovenia	0.8%	1.3%	$34,580
Emerging	Taiwan	1.8%	1.2%	$52,254
Emerging	Egypt	0.8%	0.8%	$13,736
Frontier Africa	Morocco	1.3%	0.7%	$8,607
Emerging	Pakistan	0.5%	0.7%	$5,575

Source: IMF, World Bank, 2020

Disclosure

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[i] To Have and Have Not, Ernest Hemingway, 1937
[ii] "Future Billionaire", a tro tro in Pokuase, Ghana. Battered minibuses packed with people are often the only public transportation in the developing world. They are called a matatu in Kenya, a tro tro in Ghana, a dala dala in Tanzania and a danfo in Nigeria – all uncomfortable, unsafe and uninsured but cheap and convenient.
[iii] IFC History, Establishing 'Emerging Markets', https://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc_new/ifc+history/establishing-emerging-markets
[iv] Head to Head, Lester Thurow, 1994
[v] Factfulness, Anna Rosling Rönnlund, Hans Rosling, and Ola Rosling, 2018, see also: "200 Countries, 200 Years, 4 Minutes", https://www.youtube.com/watch?v=jbkSRLYSojo
[vi] World Bank, World Development Indicators database, 2020
[vii] "TO HAVE AND HAVE NOT", Humphrey Bogart & Lauren Bacall, Warner Brothers, October 11,1944