

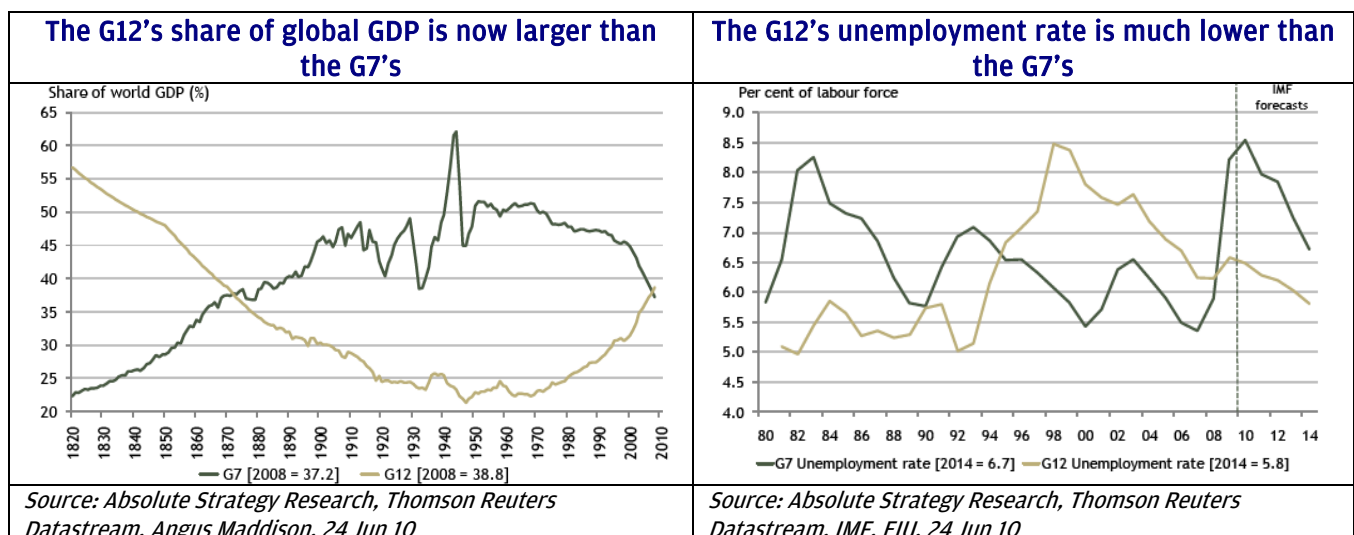
Market Focus – G12 leading the way

July 2010

Growing importance of the ‘G12’ part of G20

- ◆ The G20 summit in Toronto ended on 27 June with media hype over the pledges by the advanced economies (G7) to slash their respective budget deficits in half by 2013 and put their debt-to-GDP ratios on a downward trend starting in 2016 (except for Japan as the G20 recognises its unique characteristics – most of the high public sector debt is held domestically).
- ◆ No doubt reducing swollen budget deficits to reach sound public sector finances is essential to sustaining longer term recovery. But many may have missed the fact that the top objective of the G20 is still to achieve “strong, sustainable and balanced growth”.
- ◆ The non-G7 economies of the G20* (ie the ‘G12’) have already begun to play a more central and leading role as their share of global GDP has already surpassed the G7’s. According to IMF forecasts, by 2015 the G12 will be contributing 2.8 percentage points to world GDP growth of 4.6%, while the G7 is expected to contribute a mere 0.8 percentage points and non-G20 1 percentage point.
- ◆ The G12 economic fundamentals have improved significantly since the financial crises in the late 1990s. For example, the G12’s unemployment rate has fallen from a peak of 8.5% in 1998 to 6.5% at present, a stark contrast to the G7 whose unemployment rate has been increasing sharply from the trough of 5.4% in 2007 to the current 8.4%.

* The EU is included in the G20 but not in the G7. Therefore the non-G7 members of the G20 are 12 in number - Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, and Turkey.



- ◆ One of the key investor concerns over investing in Emerging Markets in 2010 is the emergence of a potential inflation problem. However, alongside the economic reforms introduced over the past two decades, the G12's inflation rate has been declining - from over 10% in the late 1990s to the current average of 5%. In another stark contrast, the G7 in 2010 still poses a deflation risk given ongoing deleveraging and the upcoming fiscal retrenchment.
- ◆ Furthermore, the emerging world does not share the same structural sovereign debt problems as the G7. Emerging economies' public debt-to-GDP ratio has remained below 60% since 2000 while the ratio for the G7 economies has soared to over 100%.
- ◆ Despite the G12's increasing contribution to world GDP, they are still underrepresented in global stock markets. They account for just 17% of global market cap versus the G7's 63%. However, given their much stronger economic fundamentals of the Emerging Markets, investors will inevitably over time increase their fund flows to the areas which provide more robust economic growth and company earnings prospects.
- ◆ In terms of valuations, the MSCI Emerging Market is currently trading on 13.2x trailing PER, a 9.8% discount to the MSCI World's 14.7x. This may help compensate investors for taking what historically have been higher levels of risk to invest in the EM space.

