

Emerging Markets Outlook

Using a mix of technical, fundamental and flow data, Michael Hartnett gives his outlook for the emerging markets.



TA: *Do you believe there is a decoupling between US and Asian stocks and economies?*

MH: You need to distinguish between macro decoupling and asset price decoupling. There is very clear evidence of economic decoupling between the US and the BRIC and Asian economies. In contrast asset prices are correlated. When the US stock market falls, so do Asian stock markets. But the negative hit is much smaller than it used to be.

TA: *What is your view of the Chinese stock market?*

MH: The Chinese market is oversold and investors are underweight. We say trading buy. But a renewed secular upswing in the Chinese stock market requires a sustained fall in inflation.

TA: *Do you think other markets apart from BRICs, such as the frontier markets of central Asia, will offer better opportunities?*

MH: Frontier markets offer strong, uncorrelated returns. The markets are undercapitalized and under owned, offer strong economic growth potential, and are underleveraged economies. Within Emerging Markets the BRIC markets will retain the leadership.

TA: *Which emerging markets do you think are overbought?*

MH: Morocco, Egypt and Brazil are currently the most overbought relative to their 200 day moving average.

TA: *Do any recent dips in emerging markets offer good buying opportunities or are you expecting a more sustained correction?*

MH: We've been buyers since the Bear Stearns event but we believe it's a bear market rally.

TA: *Will a decline in export competitiveness viz-a-viz a fall in the USD have a major impact? Where will its impact be felt most?*

MH: Not for the commodity producers. They love a weaker

dollar. And the Asian markets are benefiting from the strong Euro. Indeed, while export growth from Asia to the US has slowed over the past year, total Asian export growth has actually risen.

TA: *What other markets or data do you think are useful as leading indicators for emerging market equities?*

MH: Our best short term sentiment indicators are the Merrill Lynch Fund Managers Survey and the EPFR fund flow data. Emerging Markets are of course also highly correlated with many other market indicators, such as commodities, the US dollar, volatility and the S&P500.

TA: *Re portfolio/country allocation, what are the key factors in your decision-making process?*

MH: We are always overweight markets with attractive valuations (cheap PEs) and large current account surpluses. The latter implies high levels of savings and liquidity. If you can get that cheap then you are onto a winner.

TA: *Can you give us an idea of how you use EPFR data? Are you looking to follow trends or spot potential reversals when the market is over-extended? How good is EPFR data in helping you to do this?*

MH: EPFR flow data helps us to identify inflexion points in the equity market. We use flow data to develop trading rules and make directional calls on emerging markets. The data is very useful.

TA: *What techniques do you use to fine-tune/time your entries and exits? How and to what extent do you use technical analysis?*

MH: In addition to our flow and sentiment tools, we use technical indicators such as 200 day moving averages and so on to indicate breakouts and the extent to which markets are overbought and oversold. ■

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