Börsen-Zeitung

Interview with Steven Quattry, Morgan Stanley

# "Two markets outperform even the S&P"

Emerging markets expert Steven Quattry from Morgan Stanley has identified five equity markets that offer promising prospects and are also very favourably valued. in an interview with Börsen-Zeitung, the portfolio manager reveals which countries these are and which markets even beat the S&P 500.

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Morgan Stanley

**BZ: Mr Quattry, we are living in difficult geopolitical times. Nevertheless, many stock markets have performed well this year. You now see good entry opportunities in some hidden emerging markets that are trading at historically low valuations. What are they?**

We are currently going through a very interesting period. There are a number of countries that are currently facing probably the most severe economic hardship they have experienced in about 25 years. These countries include Argentina, Pakistan, Turkey, Egypt and Nigeria. To illustrate the plight, you can look at the currencies of these countries, which have fallen between 50 and 90 per cent. Yet, paradoxically, these equity markets have recovered over the last two years. Apart from Nigeria, the stock markets have risen between 20 and 80% in dollar terms. Two of them, Pakistan and Argentina, have even outperformed the S&P.

**BZ: Do you have an explanation for this?**

This can essentially be reduced to one word and that is reform. We should imagine that every economic crisis brings with it the potential for new reforms, which then create the conditions for a better situation in the coming years. Many of these countries are now implementing measures that they have resisted for years. Despite this, they are still trading at historically low valuations of between four and seven times earnings. We therefore think that this is a really interesting time to take a closer look at these markets.

**BZ: In Argentina, the libertarian President Javier Milei is considered by many observers to be at least unorthodox, if not right-wing populist. However, the markets seem to support his policies so far. Do you expect the recent record run on the local stock market to continue? And how far can it go?**

Milei may be unorthodox in his methods, but economically his policy is a very welcome shift from an unorthodox economic policy to an orthodox one. Under the previous government and through many previous governments, the country has resorted to fiscal monetisation, essentially printing money to cover government deficits. Milei is known for wielding a chainsaw at election rallies and promising to cut inflationary public spending with a chainsaw, and that is exactly what he has done. For the first time in 70 years, the government will generate a budget surplus, without the help of a commodity price boom and without some kind of one-off privatisation.Milei has the potential to bring about real regime change.

**BZ: And that can go on?**

Investors are starting to take notice. In Argentina, earnings per share have grown by 220% since 2011, while the S&P is at 177%, yet shares are still only trading at seven times earnings. So this could continue. It depends on whether Milei is able to improve the Argentinian economy or not. Reform-oriented presidents have failed in the past because there was strong political resistance to cutting government spending. However, polls show that Milei's approval rating has remained above 50% for a long time, which is a promising sign that Argentines believe that real change is needed.

**BZ: Milei's ratings have fallen somewhat recently.**

Yes, support for him has dropped a bit in recent months, falling below 50%. That's something we're watching very closely because I think it's kind of a key question as to whether or not he will be able to continue with a lot of his policies. There are some promising signs, but we'll have to wait and see how his approval ratings develop.

**BZ: In Nigeria, an ambitious president is also struggling with high inflation and currency turbulence. Why is the country promising for you?**

For me, Nigeria is the largest country in the world that investors know the least about. But that could soon change in view of some demographic trends and a possible growth spurt. The last time we saw eight years of economic stagnation in Nigeria was under the presidency of Muhammadu Buhari. However, before Buhari, between 2001 and 2014, Nigeria was one of the 15 fastest growing economies in the world. During Buhari's time in office, the average income of Nigerians fell by a third. This was one of the sharpest declines recorded by any country during this period.

By comparison, Kenya, Rwanda and Egypt recorded an increase in income of between 20 and 40 per cent during this period. The problem was really bad policy decisions and an overvalued currency that was pegged to an uncompetitive exchange rate. This robbed the country of much-needed foreign capital.

**BZ: And you believe that this will change under the current President Bola Tinubu?**

We are so enthusiastic about Nigeria because the new government has introduced some really ambitious reforms. President Tinubu was previously governor of Lagos State and during that time he gradually led the state to prosperity. He significantly improved public services and managed to convince citizens to pay more taxes in return. When he became president, he said a few things at his inauguration, such as that the fuel subsidy, which costs the government 10 billion dollars a year, would be abolished. About a month later, he abolished the different exchange rates and reunified the different rates, devaluing the currency by about 70%. These measures naturally led to high inflation in the short term. Fuel prices tripled overnight. These reforms are painful in the short term, but will allow the country to adapt and grow in the medium term.

**BZ: What else speaks in favour of Nigeria?**

When you talk to cabinet members, it is clear that their top priority is to grow the economy through private investment. And the president is a reformer who is removing some of the most important obstacles. Another reason for the promising development is that Nigeria has a population of 220 million people, and in the next ten years the labour force will increase by another 38 million. That is more than in any other country in the world except India. And when the labour force grows, the demand for consumer goods, clothing, consumer durables and other products usually increases as well. In addition, the population is incredibly young. Half of the population, over 110 million people, are under the age of 18. This young, tech-savvy population offers a number of really interesting opportunities. We are very excited about the future growth of this large country once the reforms take effect.

**BZ: In Turkey, President Erdogan has made a U-turn and switched to a stricter monetary policy. Was this the starting signal for the rapid recovery on the stock markets?**

Yes. The country had a very loose monetary policy for a long time under Erdogan, who had this very unorthodox belief that lowering interest rates was the key to fighting inflation. It was clear how that would turn out. This led to inflation rising by up to 85%, while the currency fell by 70%. After his re-election, Erdogan then took a dramatic turn towards monetary orthodoxy. He appointed a number of credible officials to both the Central Bank and the Ministry of Finance. He also raised interest rates from 8.5% to 50%. This finally began to tackle the cause of the high inflation.

**BZ: And the stock markets also picked up as a result?**

After the appointment of credible officials and the increase in interest rates, the market went up. Recently, however, there has been a sell-off in the Turkish market, partly related to the geopolitical risk that we also see. Nevertheless, we think Turkey is an interesting market. It has a number of really interesting companies that are linked to exports. A weaker currency could help these companies. And the market is only trading at 4 to 5 times earnings.

**BZ: With its interventionist military and Islamist excesses, Pakistan is considered notoriously restless. But you also see opportunities here.**

At the end of the day, we are investing in companies and the corporate sector has proven to be very resilient. In Pakistan, there are a number of secular themes that play a role, such as digitalisation and fintech. Pakistan‘s earnings per share have risen by 360% in the last 15 years or so. It has even outperformed S&P earnings per share, which have risen by 170%.

**BZ: What are you focussing on in particular?**

We have invested in the largest digital bank in Pakistan. There are only 80 million bank customers in a country with a population of around 250 million, so banking penetration is low. This offers enormous growth potential for digital banks. And this bank has achieved a profit increase of 40% per year on average and in dollar terms over the last ten years, despite the volatility of the currency and the political and economic influences. We have also invested in an IT service provider that offers its services to customers all over the world. Technology is one of Pakistan‘s outstanding sectors. Exports have risen by 24% this year to 3.2 billion dollars. That is an all-time high. And here, too, they are benefiting from a depreciating currency because the cost base is denominated in local currency and these costs fall further when the currency depreciates. However, revenue is generated in dollars, as the company serves a number of customers in theUSA and the Middle East. An interesting company like this is trading on a P/E ratio of around ten times next year‘s earnings. A similar company in the US trades at 25 or 30 times earnings.

**BZ: And what do you find fascinating about Egypt?**

When we talk about the increasing geopolitical volatility in the world today, Egypt is right at the centre of the crosshairs. It has been hit by a whole series of external shocks. Covid has hit tourism pretty hard. Due to the Ukraine conflict, wheat prices rose by more than40%. Egypt is the second largest wheat importer in the world after China. The latest problems in the Gaza Strip have once again hit tourism and oil prices have shot up. Egypt imports oil. And even the income from the Suez Canal, which in the past was a good anchor for stable dollar income, has been affected.

**BZ: That doesn‘t sound so great at first.**

Egypt has received a capital injection of 35 billion dollars from the United Arab Emirates in the Ras el-Hekmah deal. Egypt also received 15 billion dollars from the IMF and World Bank in return for a commitment to reforms. One of the reforms is that they have agreed to a nominal cap on public spending, which is quite wasteful. They have also agreed to a debt ceiling because the national debt is historically high. Egypt is therefore one of the few countries in which public debt in relation to GDP will fall significantly in the coming years. And the stock market in Egypt is trading at a rather undemanding seven times earnings.

**BZ: What all these countries have in common is that they have experienced considerable turbulence in the recent past. Can the high yield prospects really compensate for the uncertainties associated with investing in these countries?**

I‘m not suggesting that people put all their savings into these markets. But there is a strong case to be made that any global equity portfolio should allocate a small percentage of its emerging market allocation to these markets. The perception is that these markets are incredibly volatile, but while they may be economically and politically volatile, corporate earnings growth is incredibly stable. There are reasons for this. Companies are often able to pass on price increases and they are able to adjust their cost base downwards. Countries like Turkey have increased their profits faster than India, which is a global favourite. And you can buy these robust earnings at historically low valuations.

**BZ: That makes these countries even more interesting than India?**
I think the difference between a really great story and something you should invest in is the price you pay. If the S&P is trading at 25 times earnings, or the global darling of emerging markets, In-

dia, is trading at 24 times earnings, those are great stories. But you pay a high price for it. If investors are looking for something different, for some diversification, then these countries are something that are not so highly correlated with global equities. I think these markets, which trade at between four and seven times earnings, are worth a closer look.

**About:** Steven Quattry is an investor in the Emerging Markets Equity team and portfolio manager for the Next Gen Emerging Markets strategy at Morgan Stanley, where he also focuses on thematic research and travels extensively to the frontier and emerging markets he covers. He joined Morgan Stanley in 2011 and has over 20 years of investment experience.