What's Hot: Is it time to look at China again?

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2021's sharp declines in China-dominated Emerging Market equities have forced a considerable valuation re-rating - while stock exchanges in the U.S., Europe, Japan and other developed markets have largely witnessed static or rising valuations.

While the S&P 500 flirts with the 4,500 level, up from 3,756 at year-end, the MSCI China index has witnessed acute trouble, with an ugly downtrend persisting since February. You could be forgiven for not fully appreciating the damage, what with European giants such as Roche and LVMH continuing to make new highs, while American dynamos, including Facebook and Google-parent Alphabet, chug along in their multi-year ascent.

China's plunges happened across industries and business lines and at the "top of the house" too (Figure 1).

Figure 1 – MSCI China: Top 10 Components

Source: WisdomTree, MSCI as of 8/25/2021. Historical

Historical performance is not an indication of future performance and any investments may go down in value.

China's Declines Had No Shortage of Catalysts

Make no mistake, there have been several drivers. For one, the country's geopolitical risk premium has risen with each incursion into Taiwan's Air Defense Identification Zone. Additionally, the U.S. military's embarrassment in Kabul emboldens China's more hawkish generals, who may recalculate the odds of U.S. engagement in a Taiwanese military venture.

At the very least, the Afghanistan debacle gives China's social media-savvy "wolf warrior" diplomats a chance to stir the pot with antagonistic Twitter rhetoric.
Meantime, notable billionaires Bernard Arnault (LVMH) and Jeff Bezos (Amazon) have nary a fear of false sequestration, yet that is exactly the fate that befell Alibaba's Jack Ma, who disappeared for several months after criticizing China's state-owned banks.

Additionally, questions abound about the profitability of China's largest company, Tencent, owing to Beijing's crackdowns on social media and gaming. That company's weight in many Chinese indexes is in the double digits.

To add onto the mess, the global supply chain is in such disarray that the Drewry World Container Index, the gauge of ocean freight costs, popped 351% over the last year. It remains anyone's guess when the Covid-inspired mess clears a path toward greater profitability for the country's export machine.
Very grim, decidedly grim.

Nevertheless, it is all already "on the table." It's known, well-covered by the financial press. The question is if the sheer order of magnitude of the country's market declines this year offers up a buying opportunity. The answer may be yes.

Conclusion

For example, the China-heavy WisdomTree Emerging Markets ex-State-Owned Enterprises Index, has estimated three-year sales growth of 13.8%, whereas the S&P 500's projection is 9.3%.

Despite headier growth prospects, the WisdomTree index trades for 21.1 times trailing earnings and 16.5 times forward earnings, a sharp discount to the 29.5 trailing and 22.2 multiples accorded the U.S. market. Meantime, the MSCI World index of developed equities is expected to have just 8.4% annual sales growth, yet its price to earnings (P/Es) are 26.8 on trailing earnings and 20 on forward earnings.

Similarly, the S&P 500 China is currently trading at 16.9 trailing and 14.9 forward earnings.

The potential valuation case for emerging equities looks considerably more opportune than it did six months ago.

Unless otherwise stated, all data from WisdomTree as of end of July 2021.

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