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BRIC Stocks Poised to Double

By The Moscow Times

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Stock markets in the biggest developing nations may double as the U.S. Federal Reserve's monetary stimulus sends valuations back to their 2008 peak, Dylan Grice, a global strategist at Societe Generale, said Friday.

Investors have poured record amounts of money into emerging market equity funds this year as U.S. benchmark interest rates near zero spurred demand for higher-yielding assets abroad, EPFR Global data show. Fed chairman Ben Bernanke said earlier this month that more monetary stimulus may be warranted after $1.7 trillion of debt purchases failed to spur growth.

Low interest rates under Bernanke's predecessor, Alan Greenspan, helped fuel the U.S. housing boom and bust that precipitated the global financial recession two years ago, economists including John Taylor of Stanford University have said.

The MSCI BRIC Index of shares in Brazil, Russia, India and China has surged 164 percent from its 2008 low, beating the 40 percent gain in the Standard & Poor's 500 Index.

"If central banks know anything, it's how to blow bubbles," Grice, who is based in London and was ranked the No. 2 strategist behind SocGen's Albert Edwards in Thomson Extel's Pan-Europe 2010 survey, wrote in a research report. "Emerging market valuations could go much further before they could be considered seriously stretched."

Equities in the BRIC markets trade at a discount to the Standard & Poor's 500 based on a measure of profits adjusted for economic cycles, Grice said.

BRIC share prices may double from current levels if valuations climb back to 2008 levels, when they were more expensive than the S&P 500, he said. Emerging market bond valuations have already returned to their level two years ago, Grice wrote.

The combination of healthy government finances, young populations and hard-working people with low income levels makes developing nations "compelling" investment destinations, Grice wrote.

Developing nations will expand 6.4 percent next year as the United States grows 2.3 percent, according to forecasts this month from the International Monetary Fund. Brazil's economy grew 9 percent in the first quarter, the fastest pace in 15 years, while China expanded 11.9 percent, the most since 2007.

"What happens when you have a compelling investment case and too much liquidity?" Grice wrote. "You get rampant asset price inflation."

Emerging market equity mutual funds attracted more than $60 billion this year and bond funds lured more than $40 billion, on pace for record annual inflows, according to data compiled by Massachusetts-based research firm EPFR.

Buying call options on emerging market equities may be a cheap way to profit from a "nascent" emerging market bubble, Grice wrote.

Investors use options to guard against fluctuations in the price of securities they own, speculate on share-price moves or bet that volatility, or stock swings, will rise or fall. Calls give the right to buy a security through a specific date for an agreed price.

"The headache posed by bubbles depends on the asset managers' perspective; for skeptics the pain is on the way up, for true believers it's on the way down," Grice wrote. "For emerging market skeptics, such a scenario represents a positive tail risk. Options pricing currently suggests such a risk is relatively cheap to hedge."

Investors poured another $5.8 billion into emerging market funds in the third week of October, with global emerging market equity funds seeing record inflows for the second time in three weeks, fund tracker EPFR said Friday.

Investors also committed $1.4 billion to emerging market bond funds in the week as they sought shelter from the falling dollar and looked for higher yields elsewhere, EPFR said. Commodity funds also pulled in more than $1 billion.

Dedicated BRIC equity funds had their best week since February but were again eclipsed by

Frontier equity funds, which pulled in $150 million, a 145-week high.

(Reuters)

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