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bright prospects

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Michael Konstantinov explains why Brazil's prospects for value and growth are compelling.



I have been visiting Brazil on a regular basis for about the last 20 years and, throughout that time, it's been said that Brazil is the country of the future. The reason for this statement was that everyone could see the potential in Brazil which had never really been unleashed.

With respect to performance within the BRIC or emerging markets universe, there is a constant rotation going on between the different markets. If Brazil is the strong outperformer in one year, this trend may not necessarily continue in the next year.

Remarkably, however, over the last eight years Brazil has been the best overall performer within the BRIC universe. This seems quite surprising but we have to remember that in 2002, when this good performance began, Brazil was just in the process of electing President Lula. As Lula was very left wing orientated there was real concern that, driven by popular policies, he could start to nationalise key industries and companies. So the market fell to a rock-bottom valuation, with a P/E ratio of around three at that time. Since then, it has risen to a point where we now have a P/E ratio of 11 to 11.5*. Clearly, we have seen a degree of rerating during that time but it has been accompanied by very strong earnings growth as well.

showing value

If we look at Brazil within the BRIC context in terms of valuation and growth, Bloomberg Consensus numbers show that Brazil is currently* valued at 11.5x earnings, Russia around 7x, and India and China (the other two big markets) are slightly above at around 13x to 14x.

In a global context, Brazil is not outrageously expensive. If we were to compare it with five-year average multiples, it is trading slightly below average. From that point of view we still feel very comfortable with investment in Brazil. We therefore have a slight overweight in Brazil within our emerging markets and BRIC portfolios. These valuations are supported by earnings growth of around 20%, similar to what we are seeing in China and India. Only Russia is higher, and that's because the drop last year was much more substantial due to the reliance on commodities, particularly in oil.

growth story

This is certainly supported by a significant turnaround in growth, so for Brazil, the current consensus forecast is in the region of 5.5%. This is somewhere in the range of what we saw prior to the financial crisis, so it is not unprecedented. We believe that 5% is a sustainable rate, and do not expect Brazil, in the short term, to reach Chinese levels of 8% to 9%.

We believe this growth rate has also been well supported by earnings growth, which is at the upper end of the range within the emerging market universe, and also very robust compared with the other BRIC markets. Brazil is currently the most important country in the MSCI Latin America Index, with the highest weight of almost 70%. Second is Mexico with 20%. This situation was very different five to seven years ago. Not only has the price appreciation of Brazil resulted in this high weighting, but it has also performed somewhat better than Mexico, with Mexico still showing pretty good performance.

The major reason for the higher weighting, however, is the fact that we have seen many new companies coming into and broadening the market. We have not seen this to the same extent in other Latin American countries. In the short to mid term, we expect Brazil to continue to strengthen its position, to the extent where you can almost consider the Latin American index to be a Brazilian index. ●

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**As at February 2010.*

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emerging markets – Brazil

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