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The Lost Decade for Buy-and-Hold Emerging Market Investors

Abstract

- For the past decades "EM+" countries have been prone to crises and tend to experience large drawdowns (typically 35-60% in US$) every 4-5 years on average, eroding IRRs for buy-and-hold investors.

- Large drawdowns are however frequently followed by post-crisis rallies which are both substantial in magnitude (54% median IRR in US$) and highly reliable (75% *hit* ratio[1]). These provide brief "windows" where outsized returns are highly concentrated.

- Country selection and timing of entry/exit are important drivers of returns. This strengthens the case for active management in Emerging Markets, especially opportunistic strategies that seek to make concentrated investments in geographies that have suffered large crisis-induced drawdowns.

Background

Most investors are familiar with the underperformance of Emerging Market equities relative to their U.S. counterparts since the Great Financial Crisis.

Less commonly recognized is that over the past decade, most markets outside the U.S have failed to deliver even a modest *absolute* return in US$ terms - being hit by a number of crises including the European debt crisis (2010-2012), the oil/commodity price collapse (2014-2016) and numerous country specific crises such as India (2012), Brazil (2016) and Argentina (2018).

The recent COVID-19 induced market drawdown has been especially pronounced in Emerging Markets and serves as another stark reminder of the fragility and crisis-prone nature of most equity markets outside North America and Northern Europe. We have seen time and time again, the "EM secular growth narrative", so seductive to most investors and allocators, get overwhelmed during times of stress.

We use this paper to summarize our findings from an extensive historical analysis of returns over 20 years across 24 individual markets. Our analysis includes many of the countries that are classified as Emerging Markets by the MSCI, as well as a few developed markets such Italy, Spain, Ireland and Hong Kong, that have also been prone to crisis. We refer to this group as "EM+".[2]

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[1] 75% (n=108) of post-crisis rallies generated US$ returns higher than 30% in the 12 months following a market trough.
[2] We exclude China from our analysis as access to the onshore market has been difficult for international investors for most of this period.

For the past decade "EM+" countries have failed to reliably deliver attractive absolute returns to buy-and-hold investors

Exhibit A shows the returns for investments in local market indexes for 5-year rolling periods, starting on Jan 1, 2000. We believe these periods are consistent with most long-term investors' time horizons. The markets are sorted by the highest annualized returns over the past 20-years ranging from Russia (15% p.a.) and ending with Greece (-6% p.a.), the latter delivering a cumulative return of -70% over 20 years. Each observation on the table represents the annualized total US$ return, including dividends, for investing in the local market index.

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Exhibit A - Annualized Country Index US$ Returns - 5 Year Holding Periods

Country/ Index	From Jan 1 / to Dec 31	2000 2004	2001 2005	2002 2006	2003 2007	2004 2008	2005 2009	2006 2010	2007 2011	2008 2012	2009 2013	2010 2014	2011 2015	2012 2016	2013 2017	2014 2018	2015 2019
Russia	MOEX	30.3%	49.2%	55.4%	53.7%	5.6%	20.4%	11.3%	-5.7%	-6.7%	20.0%	-8.2%	-11.9%	0.9%	-0.8%	-0.6%	21.0%
Qatar	QSE	37.1%	55.1%	34.1%	34.7%	14.0%	5.1%	-0.3%	9.5%	2.2%	14.6%	17.4%	8.5%	8.2%	4.6%	4.0%	0.8%
Pakistan	KSE100	31.0%	43.6%	50.7%	37.6%	-1.0%	1.2%	-2.6%	-5.2%	-5.3%	26.4%	23.4%	17.4%	29.4%	16.1%	2.2%	-3.8%
Thailand	SETI	10.6%	28.9%	27.1%	30.5%	-4.0%	9.9%	19.8%	16.5%	17.2%	30.1%	20.0%	4.3%	9.3%	6.8%	7.4%	6.3%
Indonesia	JSE	4.6%	24.9%	44.7%	48.5%	12.0%	23.5%	31.8%	18.9%	11.6%	25.9%	11.8%	-2.3%	0.7%	2.9%	6.2%	3.6%
India	Sensex	7.9%	22.2%	38.5%	51.6%	10.8%	21.5%	18.6%	-0.1%	-5.8%	13.2%	4.6%	-1.5%	7.8%	10.1%	10.2%	7.3%
Saudi	Tadawul	32.2%	49.7%	26.9%	35.3%	2.6%	-4.2%	-15.3%	-1.8%	-7.1%	15.4%	9.4%	3.9%	5.7%	4.7%	1.6%	3.6%
South Africa	JALSH	13.9%	25.5%	36.8%	35.4%	11.3%	14.2%	14.5%	5.1%	5.0%	17.3%	5.9%	-4.7%	1.7%	3.8%	-0.5%	2.1%
Mexico	S&P BMV	11.0%	25.9%	31.1%	38.3%	17.7%	18.5%	15.2%	3.5%	6.3%	17.0%	5.0%	-3.1%	-2.3%	-4.4%	-6.9%	-2.8%
Chile	IPSA	8.7%	15.1%	23.1%	34.6%	8.1%	16.9%	22.5%	9.8%	7.9%	13.7%	-2.1%	-13.2%	-5.1%	0.2%	0.9%	-0.4%
Ukraine	PFTS	45.5%	48.2%	67.3%	87.5%	21.6%	9.6%	13.8%	-6.3%	-28.2%	0.6%	-16.6%	-38.0%	-30.3%	-20.8%	-8.4%	-0.4%
Malaysia	FTSE Bursa	5.4%	9.7%	15.4%	25.8%	8.6%	13.9%	20.4%	13.6%	8.8%	21.6%	9.9%	-1.2%	-2.3%	-1.3%	-3.4%	-2.0%
Egypt	EGX30	4.8%	43.2%	62.7%	78.0%	34.8%	21.8%	2.2%	-12.6%	-13.2%	5.6%	4.7%	-3.3%	5.4%	2.0%	-3.6%	-4.8%
Brazil	Bovespa	0.8%	13.0%	28.8%	62.4%	16.0%	31.9%	23.7%	7.9%	-3.7%	6.3%	-13.7%	-23.5%	-9.4%	-5.0%	0.8%	8.8%
Korea	Kospi	1.1%	30.7%	27.0%	33.9%	7.2%	12.9%	7.6%	2.0%	-0.2%	18.6%	5.2%	-0.3%	2.7%	5.9%	1.0%	3.7%
Taiwan	TSE	-4.3%	9.8%	12.0%	19.3%	-0.3%	10.1%	13.4%	3.3%	4.1%	19.5%	6.4%	-0.5%	7.7%	10.0%	5.8%	10.7%
Ireland	ISEQ	12.4%	12.3%	22.4%	22.1%	-9.8%	-10.5%	-12.8%	-19.2%	-12.7%	16.5%	10.5%	16.1%	15.0%	15.4%	1.7%	6.8%
Spain	IBEX	3.7%	11.3%	24.1%	33.0%	10.0%	11.8%	5.9%	-4.5%	-7.7%	7.8%	-0.7%	0.7%	2.6%	6.7%	-2.6%	1.0%
Hong Kong	Hang Seng	-1.7%	2.8%	15.9%	28.3%	4.1%	10.8%	10.7%	-1.9%	-4.5%	10.5%	1.4%	-1.4%	3.3%	5.7%	0.9%	3.1%
Argentina	MERVAL	-3.4%	4.1%	18.2%	34.1%	-3.1%	5.7%	11.7%	-3.4%	-3.2%	21.5%	10.5%	0.3%	13.2%	22.7%	-0.6%	-7.1%
Italy	FTSE MIB	0.4%	2.1%	16.5%	21.8%	0.1%	-0.4%	-4.8%	-15.0%	-14.0%	2.9%	-3.7%	0.7%	4.1%	7.4%	-1.4%	6.2%
Turkey	BIST 100	-7.5%	17.5%	25.9%	53.4%	8.7%	17.2%	10.6%	2.4%	1.2%	15.4%	3.1%	-8.2%	-1.5%	-4.5%	-8.6%	-9.0%
Portugal	PSI20	-0.3%	4.0%	20.4%	29.6%	4.2%	6.9%	4.0%	-9.7%	-12.9%	5.5%	-9.7%	-6.9%	-3.6%	0.5%	-6.6%	4.0%
Greece	ASE	-4.5%	9.9%	24.4%	36.9%	0.4%	-0.7%	-12.8%	-29.5%	-28.8%	-6.2%	-18.9%	-17.0%	-3.5%	-2.8%	-13.9%	2.5%

Source: Bloomberg, Helm analysis; Annualized total returns for local indices.

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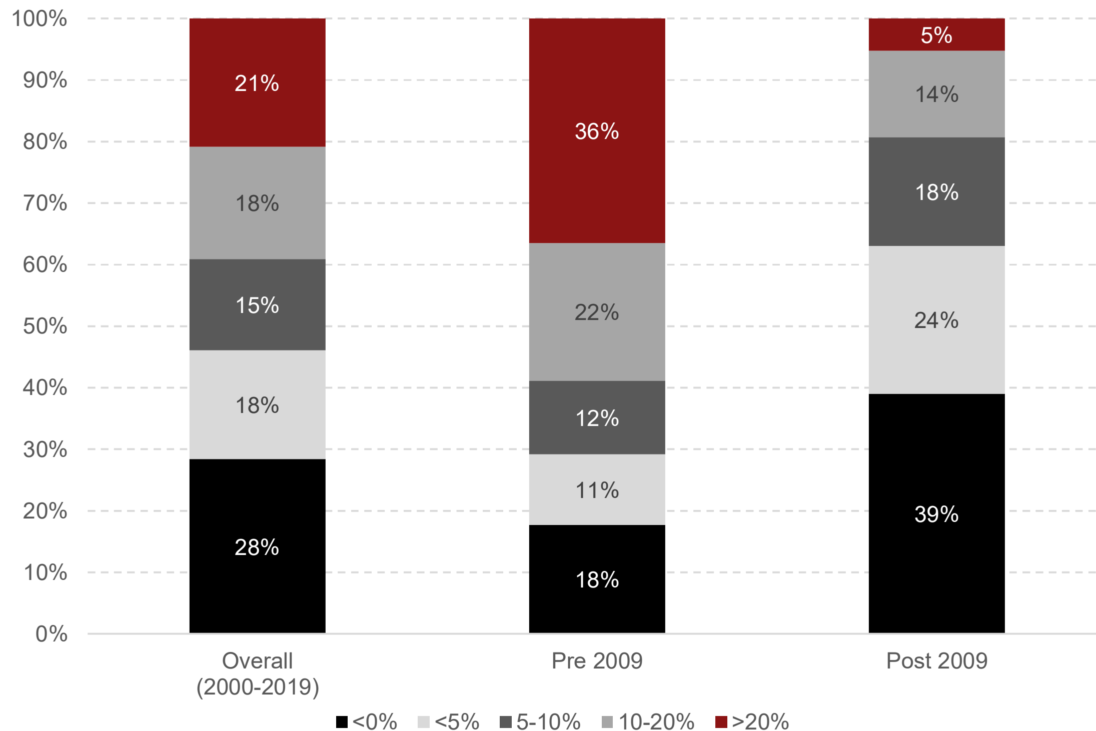
Exhibit B – classifies each of the 384 observations (24 countries x 16 periods) by returns bands.

It doesn't make for pretty reading!

Exhibit B - Frequency of Country-Level US$ Returns by Band (Annualized Over 5 Year Holding Periods)



Source: Bloomberg, Helm Analysis (1999-2019).

With the exception of the great EM bull run of 2003-2008, investing in individual EM+ countries with a buy-and-hold approach has been highly unpredictable and has rarely delivered a reasonable rate of return commensurate with most investors targets (10%+).

Since 2000, 28% of country investment windows have delivered a negative return and another 18% have delivered sub-par return of <5% p.a.

Since the GFC, the success rate is even lower, with 63% of observations failing to deliver a 5% annualized return and less than one fifth of the cases delivering better than 10% p.a. - hardly a convincing hit ratio.

Note that our analysis ends in Dec 2019 and does not include the recent COVID-19 induced drawdown - doing so would make things look even weaker across the board.

This truly has been a lost decade for EM+ investors.

EM+ markets are prone to crises and tend to experience large drawdowns every 4-5 years

Having established that investing in any EM+ market with a buy-and-hold approach has been an unreliable and (mostly) unprofitable strategy, we examine why that is the case. The explanation lies in the frequency of large drawdowns experienced by such markets, typically associated with some form of political or macroeconomic crisis. In this paper, we do not intend to diagnose the causes of these crises, but only to analyze their frequency and magnitude.

Between 2000 and 2018[3], we observe 108 drawdowns of more than 33% in US$% across the same 24 countries. *Exhibit C* summarizes the results by country. Unsurprisingly, externally vulnerable countries like Greece (7 occurrences), Turkey (7) and Argentina (8) experienced such a drawdown once every three years, on average. Even more stable countries like Korea (4), Qatar (5) and India (4) experienced large drawdowns with high regularity. On average, EM+ countries tend to experience **a major market crisis every 4-5 years,** eroding long-term buy-and-hold IRRs.

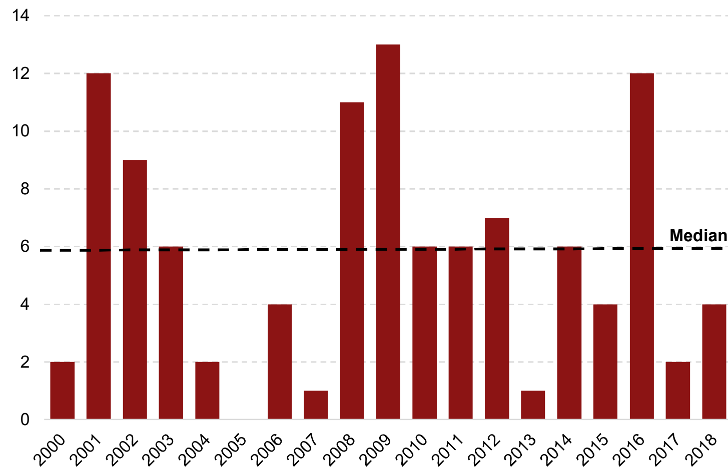
Exhibit C - Frequency of Drawdowns Larger than 33% in US$

		# of Crisis Periods[1]	Median Peak to Trough Decline[2]
Asia	Hong Kong	4	-44%
Asia	India	4	-47%
Asia	Indonesia	5	-41%
Asia	Korea	4	-51%
Asia	Malaysia	3	-44%
Asia	Pakistan	2	-66%
Asia	Taiwan	3	-58%
Asia	Thailand	2	-60%
EMEA	Egypt	6	-51%
EMEA	Qatar	5	-40%
EMEA	Russia	5	-48%
EMEA	Saudi	4	-53%
EMEA	South Africa	2	-53%
EMEA	Turkey	7	-46%
EMEA	Ukraine	6	-57%
EU	Greece	7	-61%
EU	Ireland	3	-35%
EU	Italy	5	-45%
EU	Portugal	6	-48%
EU	Spain	4	-46%
Latam	Argentina	8	-49%
Latam	Brazil	5	-67%
Latam	Chile	4	-39%
Latam	Mexico	4	-37%
MEDIAN		**4**	**-50%**

Source: Bloomberg, Helm Analysis. (1) # of occasions where local index fell 33% or more in US$ terms within 18-month window.
(2) Average peak to trough decline in US$ observed for each market.

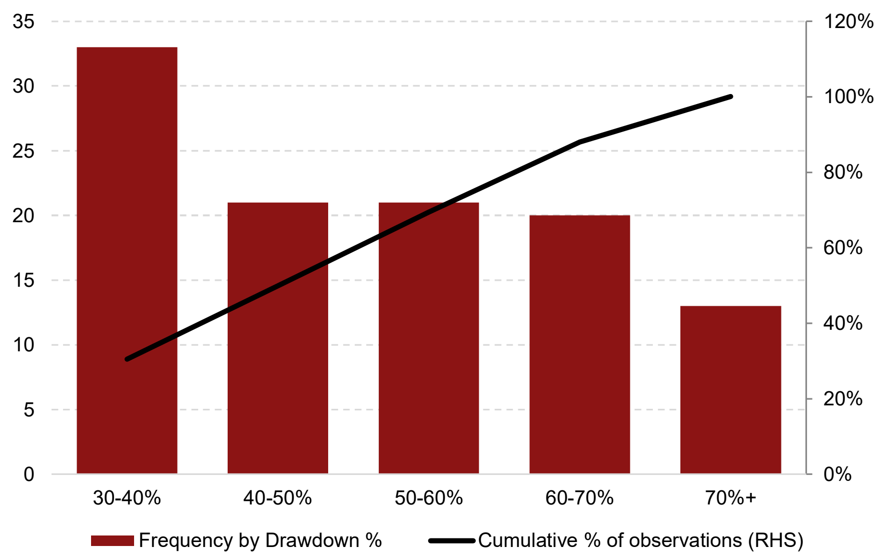
[3] We end the inclusion period in 2018 to be able to examine the 12-month post-crisis period.

While there are periods such as 2002/03 and 2008/09 when most EM+ countries are simultaneously hit by a global crisis, there are many more localized crises that take place every year based on developments and prevailing narratives at the country level.



Source: Bloomberg, Helm Analysis. Based on date of index trough; n=108

Looking at the magnitude of the drawdowns, the median peak-to-trough drawdown is approximately 50%, and 30% of the drawdowns were higher than 60%. To fully appreciate the impact of such large drawdown, one only needs to remind themselves that after experiencing a 60% drop, an index must increase by 2.5x just to recoup its previous losses.



Source: Bloomberg, Helm Analysis; n=108

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Given the frequency and magnitude of market drawdowns in EM+ countries, it is no surprise that long-term returns in these EM+ markets have been underwhelming.

Large drawdowns are most frequently followed by post-crisis rallies that are both substantial in magnitude (median 55% IRR) and highly reliable (75% *hit* rate)

As painful as large market dislocations might be, they tend to provide an attractive backdrop for subsequent returns given that substantial drawdowns are predictably followed by large, post-crisis rallies.

Exhibit F summarizes the 12-month returns for the relevant index across the 108 crisis observations. The median return is 54%. More than 75% of cases have a rally greater than 30% and approximately 35% of cases have a recovery greater than 75%.

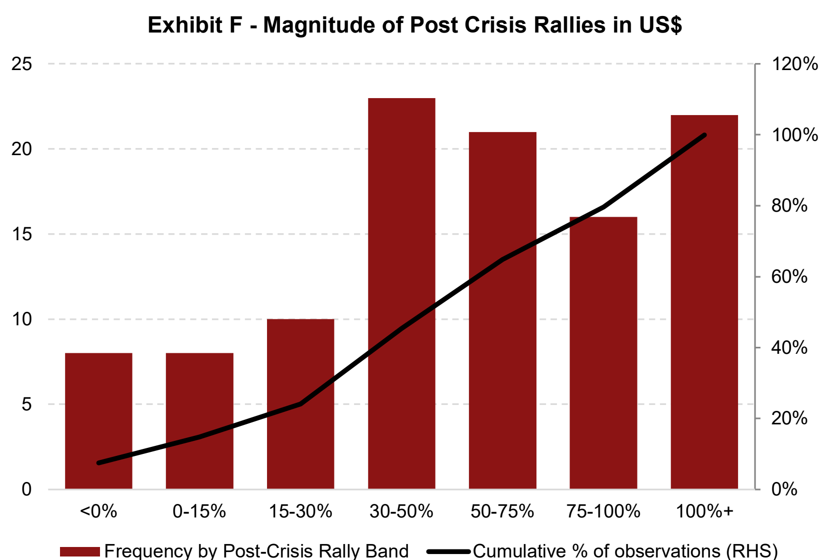


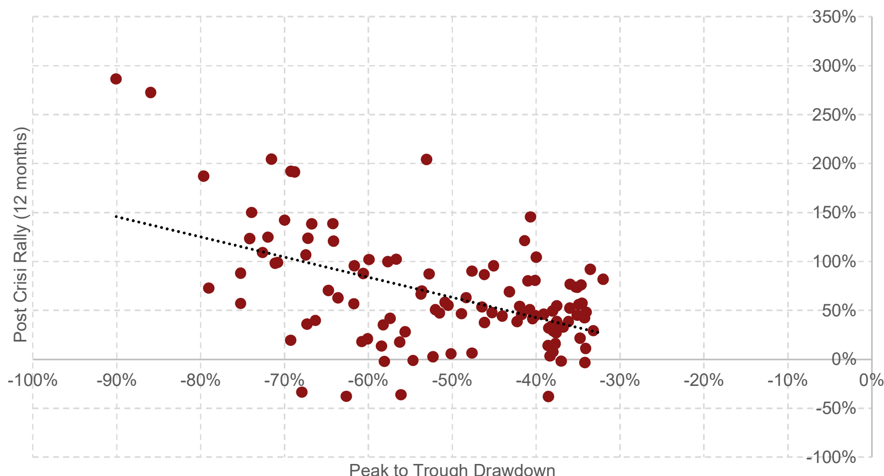
Exhibit F - Magnitude of Post Crisis Rallies in US$

Source: Bloomberg, Helm Analysis; n=108

In approximately 5% of cases the 12-month return is negative where a market recovery begins but eventually fades.

Exhibit G plots the size of the drawdown with the post crisis rally - as expected, there is a loose inverse relationship i.e. the bigger the fall, the larger the subsequent rally (R^2=0.25).

Exhibit G - Inverse Relationship between Drawdowns and Post-Crisis Rallies



Source: Bloomberg, Helm Analysis; n=108

While long-term cumulative returns for EM+ countries have been disappointing, these markets have frequently provided "windows" where outsized returns are highly concentrated- typically following a large crisis-induced drawdown.

Country selection and timing of entry/exit are important drivers of performance, enhancing the case for active management.

Emerging Markets are viewed by many as a monolithic asset class, but the data demonstrates that there is in fact low correlation and significant divergence in performance across the different EM countries (*Exhibits H and I*). The exception would be periods of global downturns, in which case the correlation becomes significant.

Exhibit H - Cross Country Correlations for Large EM+

	Brazil	India	Italy	Korea	Mexico	Russia	Saudi	S. Africa	Taiwan	Thailand	MSCI EM
Brazil		0.3x	0.5x	0.3x	0.7x	0.4x	0.2x	0.5x	0.2x	0.3x	0.6x
India	0.3x		0.4x	0.4x	0.3x	0.3x	0.2x	0.4x	0.4x	0.4x	0.6x
Italy	0.5x	0.4x		0.3x	0.5x	0.5x	0.2x	0.7x	0.2x	0.3x	0.6x
Korea	0.3x	0.4x	0.3x		0.3x	0.4x	0.2x	0.5x	0.6x	0.4x	0.8x
Mexico	0.7x	0.3x	0.5x	0.3x		0.4x	0.2x	0.6x	0.2x	0.3x	0.6x
Russia	0.4x	0.3x	0.5x	0.4x	0.4x		0.2x	0.5x	0.3x	0.3x	0.6x
Saudi	0.2x	0.2x	0.2x	0.2x	0.2x	0.2x		0.2x	0.2x	0.2x	0.3x
S. Africa	0.5x	0.4x	0.7x	0.5x	0.6x	0.5x	0.2x		0.4x	0.4x	0.7x
Taiwan	0.2x	0.4x	0.2x	0.6x	0.2x	0.3x	0.2x	0.4x		0.4x	0.7x
Thailand	0.3x	0.4x	0.3x	0.4x	0.3x	0.3x	0.2x	0.4x	0.4x		0.6x
MSCI EM	0.6x	0.6x	0.6x	0.8x	0.6x	0.6x	0.3x	0.7x	0.7x	0.6x	

Source: Bloomberg, Helm Analysis; period 2000- 2019

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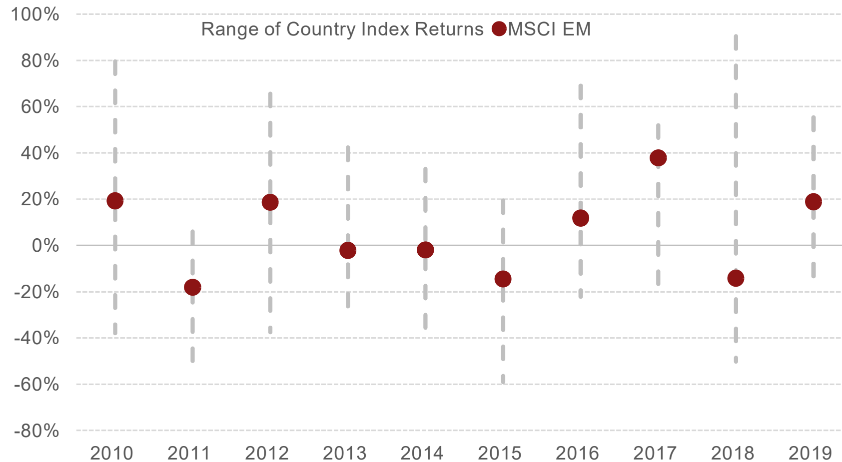
Exhibit I - Range of Local Index Returns in US$ for EM+ countries



Source: Bloomberg, Helm Analysis

Since 2010, the average annual spread between the best and worst performing country-level index is 90%.

Looking at the divergence in performance across a few seemingly similar "county pairs" (*Exhibit J*), highlights the point even further, demonstrating that local developments and narratives play out at different times in each country.

Exhibit J - Annual Returns in US$ for Select Country "Pairs"

Source: Bloomberg, Helm Analysis.

Low correlations and large spreads provide a backdrop conducive to active management, but to effectively capitalize on these cross-country divergences, **country selection and timing of entry and exit can be critical**. This is best exemplified by a few case studies.

- Argentina, a particularly crisis-prone country, delivered exceptional returns between 2013-2017 (23% p.a. in US$). This coincided with a period when President Kirchner began losing her power base and was subsequently replaced by reform oriented Macri in 2016. However, hanging on to Argentinean equities for another 12-18 months would have wiped out all of those returns as the market fell over 60% starting in Jan 2018. This was the result of Macri's inability to control inflation, stabilize the FX rate and, ultimately, preventing Mrs. Kirchner from coming back to power as Vice President.

- For most of the last decade, Russia had been a graveyard for investors due to oil price volatility and rising geopolitical tensions. However, in 2015, Russian stocks bottomed at extreme valuations following the oil price collapse, the Ukraine invasion and the imposition of U.S. sanctions. The following 5-year period delivered 21% p.a. resulting from renewed fiscal discipline coupled with recovering oil prices.

- Brazil, another disappointing market for most of the last 15 years, did provide a good investment window for those willing to enter in 2015/2016 amidst a political crisis and weak economic backdrop. After years of corruption and economic mismanagement, the PT Worker's Party rule ended abruptly with the *Lava Jato* anti-corruption operation and subsequent impeachment of President Dilma Rousseff. The political change, with VP Michel Temer replacing Mrs. Roussef, triggered a substantial market rally as the Bovespa index went up over 100% in US$ over the following 2 years, vastly outperforming EM peers.

Conclusions

We encourage readers to draw their own conclusions but history does suggest that EM+ countries are particularly prone to large, crisis-induced drawdowns (on average every 4-5 years) which has made it difficult to reliably generate absolute returns with a buy-and-hold approach. However, these drawdowns also present attractive investment opportunities in which to generate performance, given the large magnitude and high reliability of post-crisis rallies that typically follow.

For allocators and asset owners, the takeaways should be that most EM+ countries do not warrant a "strategic allocation." Rather, there is a strong case for active management in EM+, especially opportunistic strategies that seek to make concentrated investments in geographies that have suffered large, crisis-induced drawdowns.

Country selection and timing of entry/exit have historically been important drivers of investor returns in EM+ countries. In volatile, crisis prone markets, being in "*the right place at the right time"* truly makes a difference.

About Helm Investment Partners

Helm is a 100% employee-owned fund manager operating a single global equity strategy focused on investing in severely dislocated equity markets.

Helm invests in the largest and strongest domestic franchises listed in countries undergoing political or macroeconomic crisis.

To learn more about Helm's mandate for crisis investing, please visit our website at www.helmip.com or reach us at helm@helmip.com.