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EUROPE MARKETS

As Greece Joins Emerging Markets Index, Some are Wary

By ERIN MCCARTHY

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Wednesday marks Greece's return to a widely tracked emerging-markets stock index after a 12-year absence, but some fund managers aren't enthused.

Many investors who specialize in developing economies say they don't intend to invest in Greece's stock market the minute Greece officially becomes part of the MSCI Emerging Markets Index, to which about \$1.4 trillion in portfolios are benchmarked. In June, MSCI said it would again label Greece as an emerging market. Greece had been deemed a developed market since May 2001, shortly after it adopted the euro.



The Athens Stock Exchange; Greek shares have risen sharply this year. *Reuters*

After a 27% rally so far this year, Greek shares are overvalued compared with other emerging-market stocks, these investors say. Although Greece's economy is healthier than it was in 2011 when the euro-zone debt crisis was at its worst, growth in many other emerging markets is expected to outpace that of Greece.

This reluctance to jump into Greece raises questions about the rally in its shares. Observers attribute much of the climb in recent months to buying by hedge funds and other fast-moving investors. The Athex Composite Share Price Index is the world's seventh-best-performing stock index in the year to date, after those of countries including Argentina and Japan. It has outperformed the Dow Jones Industrial Average, which is up 23% this year.

Derrick Irwin, a portfolio manager with the \$4.5 billion Wells Capital Advantage Emerging Markets Fund in Boston, traveled to Greece in September to gauge the progress of reforms undertaken as a condition of two international bailouts. While Mr. Irwin says he was impressed with how quickly the country is restructuring its banking system, he isn't ready to buy Greek stocks.

"My sense with the Greek economy was that we've reached some sort of very low valley that appears to be stabilizing," Mr. Irwin says. "The question now is how wide is that valley before things get better? It's probably still pretty wide."



Fund managers of all stripes poured \$269 million into Greece's stock market this year through Nov. 13, but global emerging-market equity funds accounted for just 3% of that total, according to data provider EPFR Global. That is a reversal from last year, when investors yanked \$108 million from Greek stocks.

Because Greece's weighting in the MSCI Emerging Markets Index will be small at 0.3%, Greece's addition to the index won't necessarily lead to a pickup in the country's fund inflows, analysts say, especially given that it is being added as the result of a downgrade.

Not all emerging-market investors are being cautious. Last month, Mark Mobius, who manages more than \$40 billion in emerging-market assets at Franklin Templeton Investments, said he planned to scoop up Greek shares for the first time in more than a decade.

Bullish fund managers say MSCI companies that survived Greece's debt crisis are well positioned to thrive amid a modest pickup in growth. An economic recovery would pave the way for even more gains, they say.

Shares of Aegean Airlines SA have nearly tripled in value this year. The stock

of Greek retailer Jumbo SA is up 93%.

"It really seems like the worst is over," says Peter Frech, a portfolio manager at Quantex AG, a Swiss firm that oversees \$250 million. "The companies that are still standing and still able to generate some cash flow in this great Greek depression ... they're really attractive."

While the euro zone as a whole emerged from recession in the third quarter, Greece's economy contracted by 3% compared to the same period last year.

The European Commission expects Greece's economy to expand by 0.6% in 2014, which would end a six-year recession.

The growing disconnect between the country's growth outlook and stock performance has helped lead to a rapid rise in the stock market's price-to-earnings ratio, a metric investors use to judge whether stocks are fairly valued.

At the end of October, Greek stocks were trading at 16.5 times earnings estimated for the next 12 months, according to MSCI. That compares with a P/E ratio of 11.42 in May. Based on this gauge, Greek stocks are more expensive than those of most other stock markets in the emerging-markets index. The Philippines, Mexico and Colombia are the only ones with higher P/E ratios.

Even among investors focused on Europe's other economies, Greece is no bargain.

"From a valuation perspective, Greece doesn't look particularly attractive compared to the rest of Europe," said John Chisholm, chief investment officer of Acadian Asset Management LLC. Mr. Chisholm also oversees \$1.4 billion of the Vanguard Global Equity Fund, which currently has no holdings of Greek stocks.

"Even though the picture has stabilized and the political systems are not falling apart ... there's not enough positive [development] in the near term," Mr. Chisholm added.

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