Bank of Nova Scotia (TSX:BNS) Is the Best Way to Play a Rebound in Emerging Markets

Description

Emerging markets have been battered since the start of 2018 to see the **iShares MSCI Emerging Markets ETF** down by almost 18% since the start of 2018. There are a range of reasons for this, but in early 2018 there were fears that a new emerging markets crisis was developing that had the potential to trigger a full-blown financial catastrophe. Higher interest rates and a stronger U.S. dollar caused a range of currencies among developing nations to collapse, placing considerable pressure on already poorly managed, overleveraged, and fiscally weak economies. While there may be further pain ahead, there are signs that the worst is over and a full-scale crisis won't emerge.

With that in mind, it is time for investors to consider bolstering their exposure to emerging markets. One of the easiest ways of doings so without leaving the safety of Canada is by investing in **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS).

Now what?

Over the last decade, Scotiabank has invested considerable capital in building a diverse international banking business focused on Latin America. Between 2012 and 2018, net income reported by Scotiabank's international business grew by 43% to almost $2.8 billion to now represent almost a third of its net earnings.

That solid growth came on the back of a range of acquisitions, which sees Scotiabank ranked as a top 10 bank in Mexico, Colombia, Peru, and Chile. Those countries possess some of the fastest-growing economies in the region. For 2019, the International Monetary Fund (IMF) expects regional GDP to expand by 2.8% with the standout performers being Peru and Chile, which are projected to grow by 4% and 3.3%, respectively. This return to growth is being led by the recovery in commodity prices, notably base and precious metals, which are major exports for those nations.

If global growth remains firm over the course of 2019, which is increasingly likely as the threat of a full-blown trade war between China and the U.S. wanes, it will buoy demand for base metals such as copper, lead, and zinc, giving the economies of Chile and Peru a healthy boost. It should also be noted that Colombia, Chile, and Peru are among the most fiscally stable and predictable economies in Latin America, further enhancing Scotiabank's opportunities for growth. This is because there is a direct correlation between economic growth and demand for credit.

Because of higher headline interest rates and low expenses, Scotiabank's Latin American operations are highly profitable. For the full year 2018, the bank reported a net interest margin (NIM) for international banking of 4.65%, which was more than two full percentage points higher than the NIM for its Canadian business.

Another key measure of a bank's profitability is its efficiency or productivity ratio, which measures the institution's ability to turn resources into revenue. Typically, the lower the ratio, the better, with anywhere around 50% considered to be optimal. For its international business, Scotiabank announced an impressive 2018 productivity ratio of 53.5%, although this was marginally higher than the 49.8% reported for Canadian Banking.

The prospects of firmer economic growth in Colombia, Chile, and Peru also bodes well for credit quality, because it should lead to lower volumes of credit losses and non-performing loans. That will reduce the amount of capital required to fund provisions, meaning that it can be directed to more productive purposes, further enhancing Scotiabank's growth profile.

So what?

Scotiabank's international operations reduce its dependence on Canada's oversaturated financial services market and mitigates the impact of a cool domestic housing market on its growth prospects. That — along with its focus is on some of the fastest-growing economies in South America — enhances Scotiabank's growth profile, which should see lending and deposit-taking activities expand at a solid clip, which will boost earnings and ultimately its stock. While waiting for that to occur, patient investors will be rewarded by Scotiabank's steadily growing, regular sustainable dividend yielding a juicy 4.7%.

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