Invest in Bank of Nova Scotia (TSX:BNS) to Benefit From an Emerging Markets Recovery

Description

Emerging markets are gradually coming back into favour after a nervous 2018, when there were considerable fears that a new financial crisis would engulf a range of developing nations. While that crisis didn't happen, the increasing likelihood of it occurring coupled with higher U.S. interest rates triggered a sharp outflow of capital from emerging markets, pushing the **iShares MSCI Emerging Markets ETF** down by 19% over the last year. Those capital outflows have left many emerging markets attractively valued, leading some analysts to assert that they have bottomed and now is the time to invest. There are also a range of positive catalysts that will propel emerging markets higher over the coming year.

Now what?

Key among those catalysts is that the likelihood of a full-blown trade war between the world's two largest economies the U.S. and China is diminishing. Signs that President Trump and President Xi Jinping are patching up their differences over trade and tariffs, including taking a more conciliatory approach, bodes well for global economic growth. That will cause commodity prices to firm, particularly if Beijing elects to engage in further fiscal stimulus, which many economists are tipping will occur.

China's government has made it clear that maintaining gross domestic product (GDP) growth of above 6% is an important aspect of economic policy. Because of the restrictions on monetary policy, any attempts at promoting growth will be made through fiscal means, which usually takes the form of tax reduction or spending on infrastructure.

Beijing has loosened the capital requirements for banks, which it hopes will boost the supply of credit, and flagged that further tax cuts are likely. This will lift manufacturing and construction activity, which the last round of data released by the government showed were weaker than anticipated.

If the stimulus is successful, it will lift demand for energy and base metals as economic activity expands. That will spur economic growth among many developing nations, particularly in Latin

America, where the extraction as well as export of oil and metals is an important driver of growth. The upbeat outlook surrounding crude, because of OPEC's latest round of production cuts, has seen analysts predict that Colombia's GDP will expand by 3.5% during 2019. Precious and base metals producers Chile and Peru are expected to experience GDP growth of around 4% over the course of the year.

This bodes well for **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), also known as Scotiabank, which has invested heavily in expanding its operational footprint in those Latin American nations. For this reason, Scotiabank's international business is now responsible for around a third of its net income. The improving economic outlook in Latin America — especially in Colombia, Peru, and Chile, where the majority of Scotiabank's international business is located — will drive greater demand for credit and other financial services.

The return to growth among those economies is already evident from the bank's fourth-quarter 2018 results, where net interest income from international banking grew by an impressive 22% year over year. That was driven by solid growth in mortgages, credit cards, and business loans in Latin America. Deposits also experienced strong growth, expanding by a notable 20% for the period.

An attractive aspect of Scotiabank's international operations is their considerable profitability compared to its Canadian business. This is because higher official interest rates mean that the bank can generate an impressive net interest margin of 4.52%, which is almost double the 2.45% reported by its Canadian business for the fourth quarter.

So what?

Scotiabank's considerable exposure to Latin America not only enhances its growth prospects but also helps to reduce the impact of a slowing Canadian housing market on mortgage lenders. This — along with it trading at 10 times trailing earnings and 1.4 times its book value — means it is very attractively valued. While investors wait for its stock to appreciate, they will be rewarded by Scotiabank's sustainable dividend yielding a juicy 5%.

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