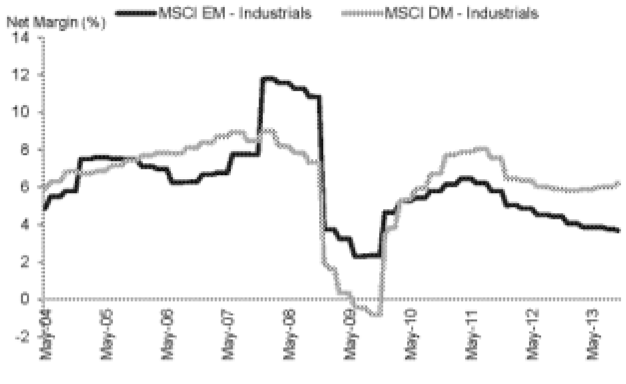
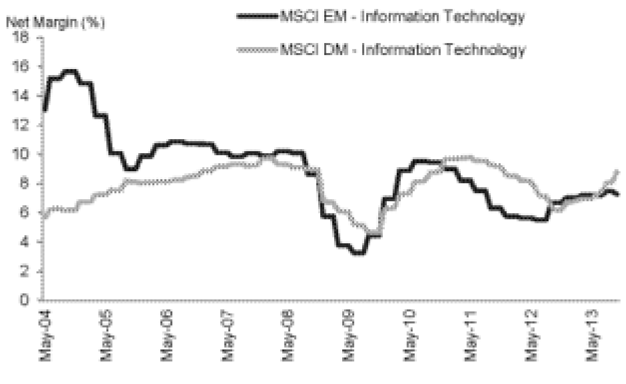
6) IT and industrials have moved in favour of DM which reflects favourable secular trends, most notably outsourcing from DM to EM companies and the growing importance of DM intellectual capital.

Figure 26: EM vs DM net margins (%) – Industrials




Source: Deutsche Bank, Bloomberg Finance LP

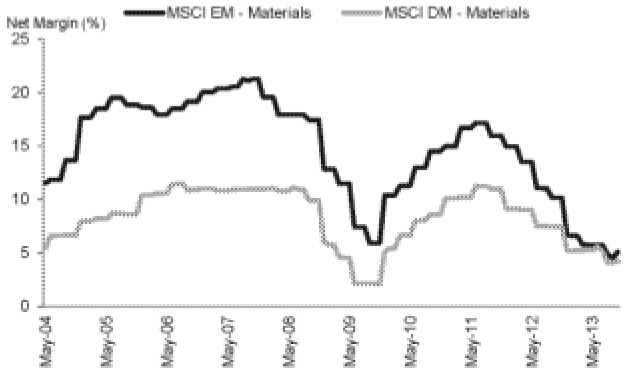
Figure 27: EM vs DM net margins (%) – Information Technology




Source: Deutsche Bank, Bloomberg Finance LP

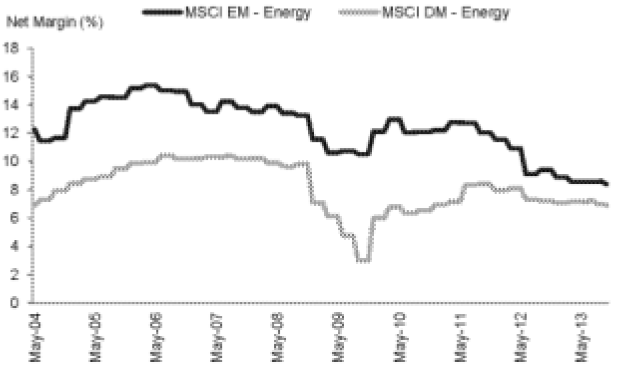
7) EMs have fared especially badly in energy and materials primarily due to the impact of policies based on state capitalism and resource nationalism, which have reduced returns to capital.

Figure 28: EM vs DM net margins (%) – Materials




Source: Deutsche Bank, Bloomberg Finance LP

Figure 29: EM vs DM net margins (%) – Energy




Source: Deutsche Bank, Bloomberg Finance LP

Conclusion; valuation now ambivalent, but the secular decline of EM profitability relative to DM is likely to continue across most sectors.

Whilst the secular strengths of the US model are increasingly factored into valuations (Figure 30 and Figure 31), there is no obvious end to the likely degradation of margins of EM companies in the regulated and resource sectors, relative to their DM peers. Continued DM outperformance in Industrials and IT is also highly likely in our view, given the ongoing secular trends, whilst EM staples stocks appear very expensive relative to their DM counterparts based on their respective return profiles. Financials are a much more difficult call, but given our negative structural view on China, we believe that investors are right to price in a very substantial impairment of assets in China, Brazil and Russia, while India is also problematic. The DM financials sector is still under pressure from increasingly burdensome regulation and litigation relating to the financial crisis, but would appear to be at a better position in the economic cycle than most GEM economies.