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and the world's foremost experts



The success of
small countries
and markets

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Introduction

In August 2014, we launched our “Success of Small Countries Report.” At the time, much of the focus in the media was on Scotland ahead of its referendum on independence from the United Kingdom. In the report, we found that small developed states and separate customs territories (World Trade Organization definition) were economically more successful than their larger peers and that, importantly, they tended to be more globalized. Further, we found that they typically are the leaders in putting “intangible infrastructure” factors like education, technology and healthcare to work in driving growth. We created a “CS Country Strength Index” and found that six of the top ten countries by “strength” are small ones.

Since then, the small country narrative has grown, not simply in terms of Greece’s economic travails, but more pertinently in the way that small states have clearly become the lead indicators of new trends in the world economy. Take Switzerland and Denmark, for example, where dramatic and new monetary policy actions have emphasized the way in which small developed countries need to react to buffer financial flows.

More than ever before, small countries are acutely exposed to the economic and political challenges of a changing global environment. Consider the ways in which New Zealand and Norway are registering the side effects of slower growth in China, the social costs of austerity evident in Ireland and Portugal or the difficulty that central banks in the Nordic region have in containing the side effects of imported deflation, and it is clear that small countries are the dashboard on which many of the world’s imbalances first become evident.

Small countries provide an indication of the future for large countries, and a test bed as to what works and what does not. One innovation in this report is to measure the way in which small countries lead larger ones in terms of economic performance. Within Europe, we find that for fiscal and debt-related indicators, small countries appear to be “canaries in the coal mine.” Singapore, it seems, also plays this role on a global basis.

Finally, we take the novel approach of tying small countries’ macro performance to the performance of their capital markets. Comparing small to large company investments is common in markets, but we find relatively little emphasis on small versus large countries from an investment perspective. Interestingly, in the long term, small developed country equity markets have outperformed large country ones. The same is true, though less emphatically so, for small developed country bond markets. We also examine the risk properties and sector composition of small country stock markets. Our ultimate aim here is to construct a portfolio of companies that are based in small developed open economies. We will publish the results of this in related investment publications.

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Figure 1

MSCI World and episodes of small developed country out/underperformance

Source: Datastream, Credit Suisse

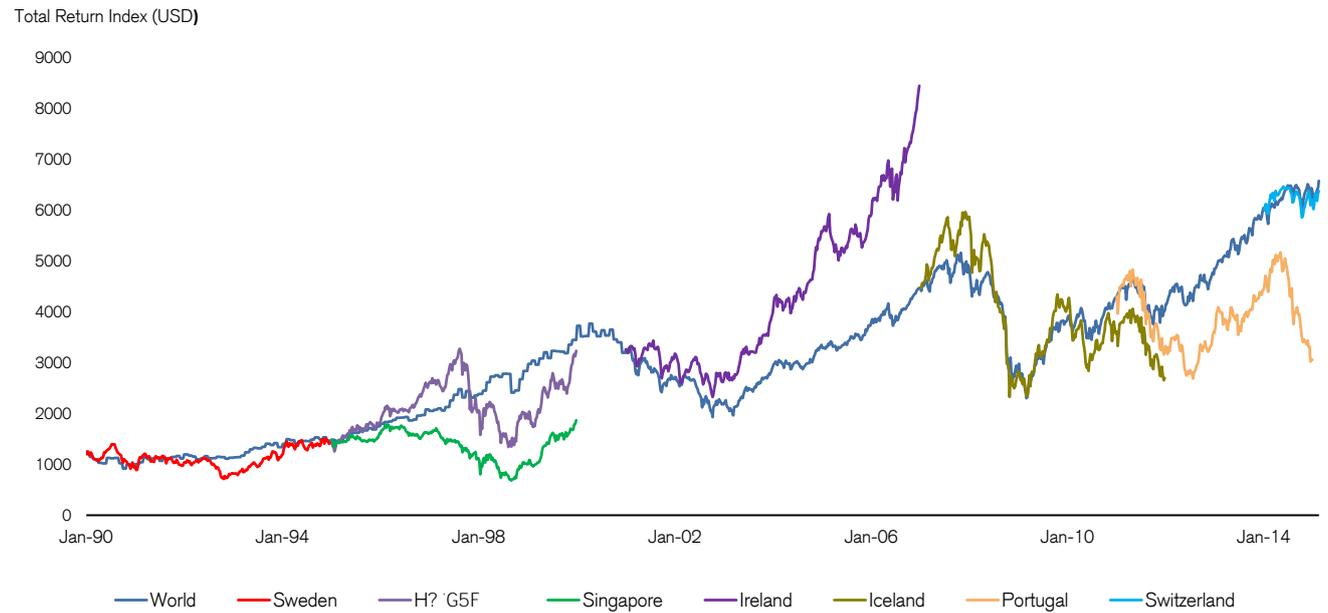
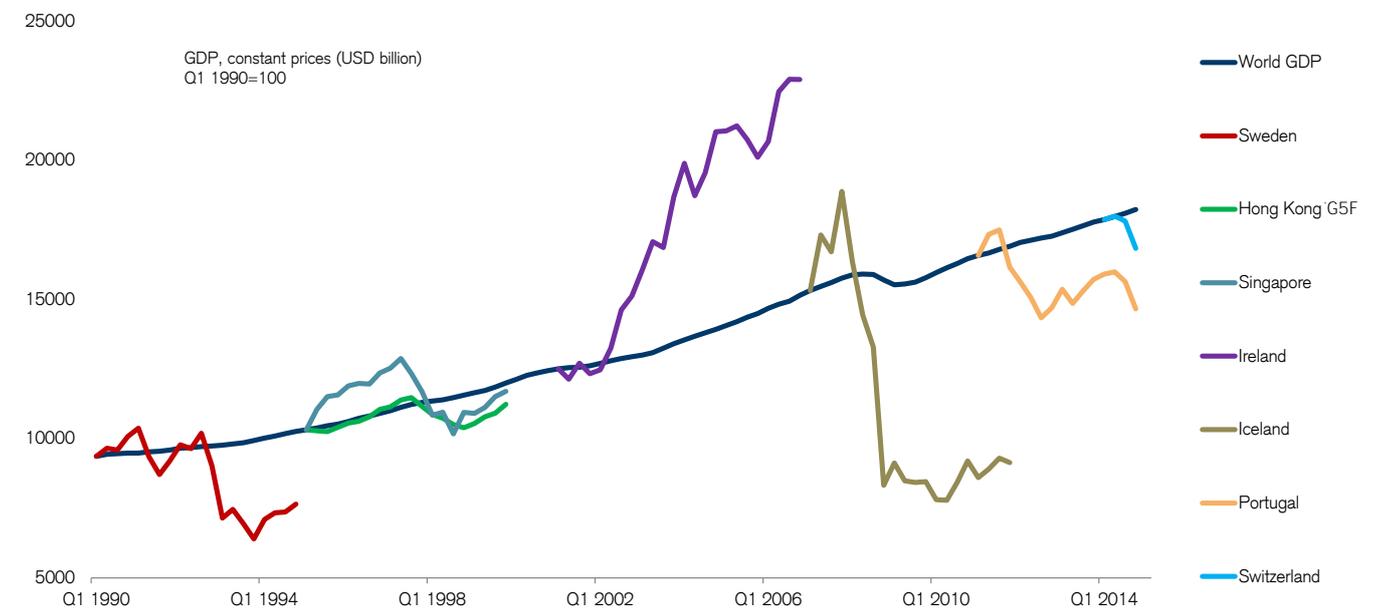


Figure 2

World GDP and episodes of small developed country out/underperformance

Source: Datastream, National sources, Oxford Economics, Credit Suisse



Canaries in the coal mine

Small countries have been in the vanguard of the rise of globalization and, at a more detailed level, they can be seen as the test beds of globalization – many of them have to deal with emerging problems such as negative interest rates, tensions caused by immigration and austerity – ahead of larger countries. In this way, they are “canaries in the coal mine” of the world economy.

The wave of globalization that began with the fall of communism has been marked by the rise of small countries. Many of them have enjoyed “Tiger” like bursts of growth and prosperity, and some of some them have equally met jarring corrections and, more recently, recoveries. GDP growth and slow market performance (Figures 1 and 2) show wider variations relative to the global trend. As we found in our original report, small developed countries are in the vanguard of globalization. In order to better outline our results, we establish three country groupings – small developed “blue chip” countries, large developed countries and small developing countries¹. Small developed countries lead the world in terms of how open their economies are (Figure 3) and relatedly how globalized they are (Figure 4). We also show that small developed countries have lower debt-to-GDP ratios and inflation rates than larger countries (Figures 5 and 6).

We have recomputed our Globalization Index by drawing together data on three component parts – economic, social and technological². Table 1 shows that small countries like Singa-

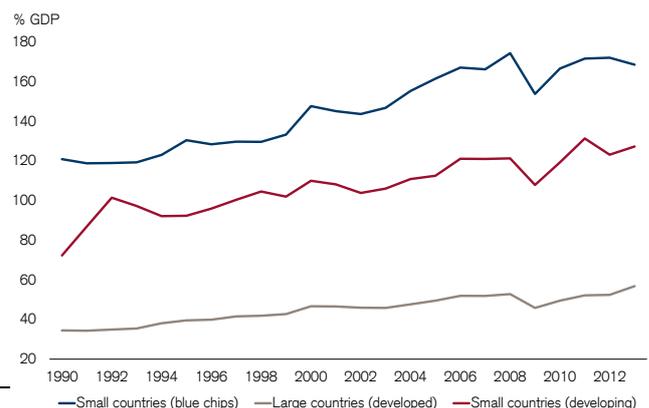
pore, Hong Kong SAR (Special Administrative Region) and Switzerland lead the globalization rankings. According to our analysis, in 2000, 76% of the top 25 most globalized countries were “small,” and this has now risen to 84%. At the same time, there are now fewer small countries in the bottom 25 globalized countries.

There is a very clear clustering of small “entrepot” economies at the top of the globalization league table – a trend that also highlights how vulnerable their economies are to financial, labor and trade flows. Further, in aggregate, small developed countries outrank larger and medium ones when we dissect the component parts of the globalization rankings (Figure 7).

Figure 3

Small developed economies are more open than larger ones (trade as % of GDP)

Source: World Bank, Credit Suisse



¹ Large developed – Australia, France, Germany, Italy, Japan, Spain, UK and USA; small developed – Austria, Belgium, Denmark, Finland, Norway, Portugal, Iceland, Ireland, Sweden and Switzerland; small developing – Czech Republic, Estonia, Hungary, Israel, Singapore, Slovakia, Qatar, UAE, Latvia and Croatia. For the sake of comparison we have also included Hong Kong, which is a Special Administrative Region of the People’s Republic of China.

² Economic globalization: trade openness (% of GDP), FDI (% of GDP), FPI (% of GDP); social globalization: cell phone subscription (per 100 people), telecom lines (per 100 people), remittances (inward and outward, % of GDP), corporate openness included factors like the ease of doing business rank (by World Bank), import delays (in days), mean tariff rates (in %), taxes on trade (% of government revenue); technological globalization: internet users (per 100 people), secure servers (per million people)..

Table 1
Small countries dominate CS Globalization Index rankings

Source: Credit Suisse

Country	Size	Score
Luxembourg	S	0.97
Singapore	S	0.89
Switzerland	S	0.87
Hong Kong SAR	S	0.84
Ireland	S	0.82
Belgium	M	0.81
Hungary	S	0.81
Iceland	S	0.81
Netherlands	M	0.80
Malta	S	0.80

CS Country Strength Index

Similarly, in our 2014 report, we computed a “CS Country Strength Index,” the object of which is to rank countries on the basis of the quality of their institutions and intangible infrastructure (we developed this theme in a previous Credit Suisse Research Institute report, “Intangible Infrastructure – The key to growth,” published 8 December 2008, and we define intangible infrastructure as “the set of factors that develop human capability and permit the easy and efficient growth of business activity”), their aptness to thrive in a globalized world, their ability to produce sustainable and lower volatility macroeconomic output and their level of human development. These many angles are closely related and, in most cases, the causality between them is hard to unravel. Our sense is that by looking at social and institutional aspects of states as well as economic ones, we achieve a more well-rounded view of a state and in particular its ability to withstand stress.

In detail, the factors we consider are as follows:

- The UN Human Development Indicator.
- The Credit Suisse Intangible Infrastructure Index.
- The Credit Suisse Globalization Index.
- Macroeconomic volatility.³
- Governance.⁴

Table 2 shows that small developed countries continue to dominate, with seven small developed countries (Switzerland, Denmark, Hong Kong SAR, Singapore, Norway, Finland and Ireland) in the top ten together with Australia, the UK and the Netherlands. Since our last review, the main changes are that Singapore has dropped three places, Australia has risen three places, and Finland has jumped to number nine.

³ Here we have taken two variables – standard deviation of GDP growth rates and inflation, taken from the World Bank database, from 1960 onward.

⁴ The average of Transparency International’s Corruption Perceptions Index Center for Systemic Peace’s State Fragility Index.

Figure 4
Small developed countries have a higher average ranking according to the CS Globalization index

Source: Credit Suisse

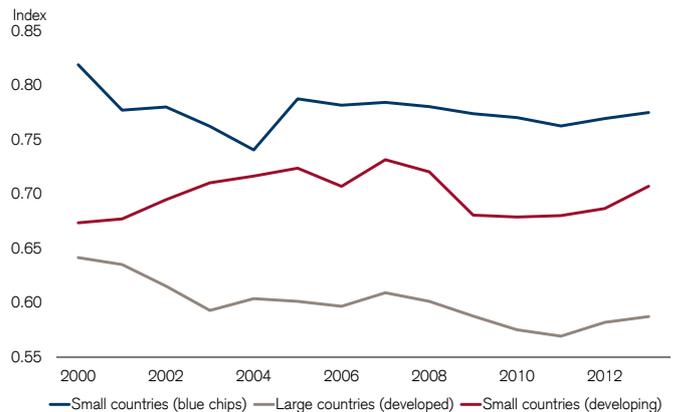


Figure 5
Debt to GDP elevated for large countries (including Japan) but not as much for smaller countries

Source: World Bank, Credit Suisse

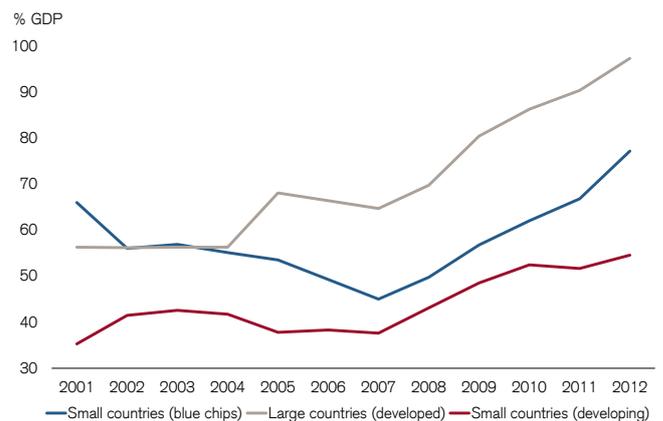


Figure 6
Inflation is less problematic in small developed countries

Source: Datastream, Credit Suisse

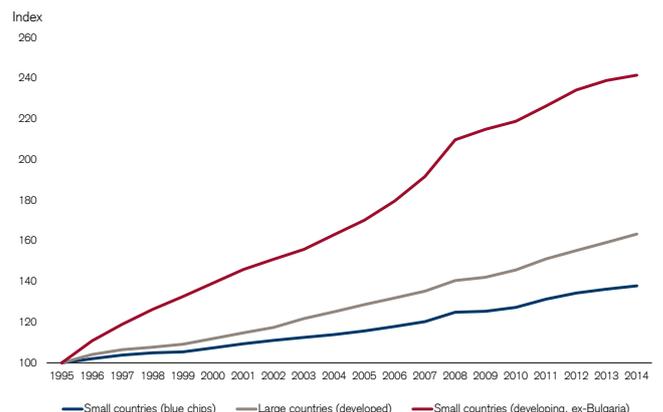


Table 2
Small countries dominate the CS Country Strength Index

Source: Credit Suisse

Country	Size	Country Strength Index
Switzerland	S	0.87
Australia	M	0.85
Denmark	S	0.83
Hong Kong SAR	S	0.83
Netherlands	M	0.83
United Kingdom	L	0.82
Singapore	S	0.82
Norway	S	0.82
Finland	S	0.80
Ireland	S	0.80
Belgium	M	0.79
New Zealand	S	0.79
Austria	S	0.79
Israel	S	0.79
Iceland	S	0.79
Luxembourg	S	0.78
Sweden	S	0.78
Korea, Rep.	L	0.77
Canada	L	0.76
France	L	0.76

Figure 7
Sub-components of Globalization Index: Small countries have performed well on all sub-indices

Source: Credit Suisse

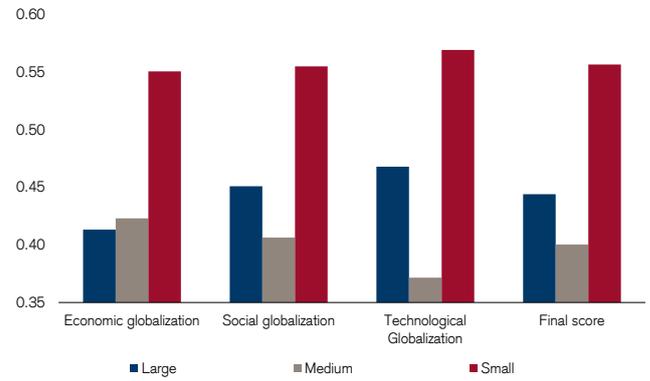


Figure 8

Lead indicators heat map

Source: Credit Suisse

	Old small								New small					Large countries									
	Austria	Denmark	Finland	Iceland	Ireland	Norway	Portugal	Sweden	Switzerland	Czech Rep.	Croatia	Hong Kong	Hungary	Latvia	Singapore	Australia	France	Germany	Italy	Japan	Spain	UK	USA
1991	-0.12	-2.29		0.01		-1.96		-1.66						-0.36	-1.26	-0.01	-0.22	-0.10	0.15			0.23	
1992	1.12	0.61		0.33		-0.94		-1.21						1.18	-1.42	-2.01	0.61	1.01	0.15			-0.92	
1993	-1.06	-0.29		-0.74		0.73		-0.15						0.81	-0.14	-0.51	0.99	1.12	0.15			-0.48	
1994	-0.97	-0.63		-0.24		0.93		0.48						-0.42	0.79	0.71	-0.20	0.27	0.15			0.27	
1995	-1.27	0.02		0.91		1.88		0.45						-0.61	1.14	-0.09	-1.76	-0.44	-0.57			0.27	
1996	1.55	0.65		0.25		1.13		1.42						-0.99	1.11	1.91	0.95	0.13	-0.22			0.80	
1997	1.96	0.77		0.33		0.46	0.66	0.42	-0.64					0.20	0.90	0.01	0.10	2.48	0.92			0.86	
1998	-0.63	0.40		-0.45		-1.43	-0.37	0.71	0.99	-0.03				-1.76	0.16	0.52	-0.56	0.05	-0.14			0.89	
1999	-0.60	1.21		0.48		0.88	0.33	-0.06	1.42	-0.54				0.97	0.75	0.18	0.19	0.66	-1.36			0.37	
2000	-0.82	0.32	2.96	0.13		1.31	-0.76	0.47	2.11	0.43				0.93	0.43	-0.99	-0.59	-1.47	-0.37			1.25	
2001	2.30	-0.50	-0.85	-0.96	-1.71	-0.16	-0.57	1.07	-2.01	-0.44				-1.16	-0.89	-0.03	-1.71	-2.16	1.26	0.15		-2.00	-1.29
2002	-0.07	-0.48	-0.14	-0.06	0.15	-1.26	-0.16	-0.83	-0.56	-1.13				0.22	0.25	-1.43	-0.47	-0.58	-0.88	0.32		-1.48	-0.53
2003	-0.06	0.16	-0.86	0.08	0.65	-0.38	-0.23	0.27	-0.87	-0.43				0.53	0.72	-0.12	-0.20	-0.87	0.01	0.15		-0.97	0.14
2004	-0.93	1.33	-0.54	0.20	-0.34	-0.06	-0.26	0.01	-0.05	-0.22	1.23	1.71		-0.02	0.35	0.08	-0.58	-0.24	1.27	0.16	-0.19	0.82	
2005	-0.15	1.73	0.28	1.23	-0.44	0.21	-0.25	0.41	0.60	0.89	0.49	-0.66		0.59	0.52	0.00	0.73	-0.68	0.97	0.55	0.10	0.73	
2006	-0.90	-0.43	0.42	0.64	-0.46	0.51	1.43	-0.20	1.07	-0.27	0.49	0.91		-0.21	0.05	1.18	0.37	0.55	0.91	0.30	0.37	-0.26	
2007	-0.27	-0.25	-0.02	-0.49	-1.65	0.06	-0.27	0.36	-0.22	-0.67	-0.26	1.03	1.68	1.47	-0.34	-0.82	1.33	0.25	1.11	-0.23	-0.37	-1.03	
2008	-0.01	-1.04	-0.28	2.60	-1.06	-0.12	-0.82	0.05	0.59	0.26	-0.23	2.16	-0.23	-1.42	-2.04	-0.10	-0.16	-0.79	-0.77	-2.49	-0.75	-1.09	
2009	-0.58	-2.47	-0.95	-1.92	1.45	-1.90	-2.49	0.11	-0.38	-0.88	0.48	-0.21	0.58	-1.77	-2.53	-1.89	-0.35	-0.78	-2.59	-1.69	-2.07	-1.09	
2010	-0.18	0.19	-0.88	2.21	1.00	0.04	0.05	-0.48	-1.02	-0.70	-0.88	0.79	-1.26	1.63	-0.25	-0.23	-2.12	-0.08	-0.16	0.82	1.07	1.12	
2011	0.70	0.50	0.32	0.00	0.90	0.68	1.53	-0.16	-0.03	0.02	-0.32	0.08	-0.38	0.61	0.56	1.33	1.60	-0.40	-0.20	0.30	1.42	1.21	
2012	0.55	0.09	-0.08	0.58	0.91	-0.42	1.59	-0.06	0.25	0.15	1.61	-0.31	0.98	1.14	-0.05	0.83	1.02	1.17	1.55	0.67	1.09	1.13	1.27
2013	0.35	0.42	0.61	0.07	0.73	-0.19	0.59	-0.15	-0.29	0.24	-1.93	-0.81	-0.38	-0.76	-0.56	0.33	1.29	0.65	0.50	0.11	0.57	1.17	0.00
2013	0.35	0.42	0.61	0.07	0.73	-0.19	0.59	-0.15	-0.29	0.24	-1.93	-0.81	-0.38	-0.76	-0.56	0.33	1.29	0.65	0.50	0.11	0.57	1.17	0.00

Small countries as lead indicators

Having underlined that small countries are at the fore of this wave of globalization and in many cases are among the first to experience emerging trends in the global economy, we investigate the view that they are lead indicators of trends in larger countries. Specifically, we examine whether small countries can tell us something in advance about fiscal, monetary and balance of payment trends in large countries.

To illustrate this, we create a heat-map based on macro indicators⁵, for 23 countries (eight large and 15 small), see Figure 8. The idea of the heat map is that it flashes green where indicators are rising above their average levels (based on a measure called a Z score)⁶. For each macro variable, we measure the consistency of small countries as lead indicators of a change in behavior, and then examine the large country signals to see if they follow small countries. For such variables, we then see which small countries have been the best leading

indicators of activity in larger countries. We then pick the corresponding large countries for which these small countries have acted as “canaries in the coal mine.”

Our results show that, largely in a European context, a range of small countries – Austria and Denmark for example, appear to act as “canaries” for larger countries when we consider trade, government spending, non-performing loans and fiscal balance (Figure 9 helps to illustrate this). Outside Europe, Singapore shows a close leading relationship with fiscal trends in the USA.

We think two effects might help explain why small countries appear to act as leading indicators for trends in larger ones. The first may come from anticipation. Small countries open to trade are likely to depend heavily on the economic policies of their larger trading partners. Accordingly, they might embark earlier on fiscal stimulus or austerity programs than their larger partners to allow for the effects of fiscal pass-through to run into the economy, before larger countries make such moves. For example, Singapore's fiscal policy has tended to follow the changes in US fiscal numbers, becoming more expansive some years prior to US fiscal expansion episodes, possibly to create excess capacity well in advance of incoming US external demand.

Second, we flag an integration effect that causes small countries in closely knit trade or fiscal networks to show signs of unusual movements, owing to their smaller share in the network, before these impact larger members. For example, non-performing loans in small countries rose faster in the Eurozone before a similar effect was seen in larger countries.

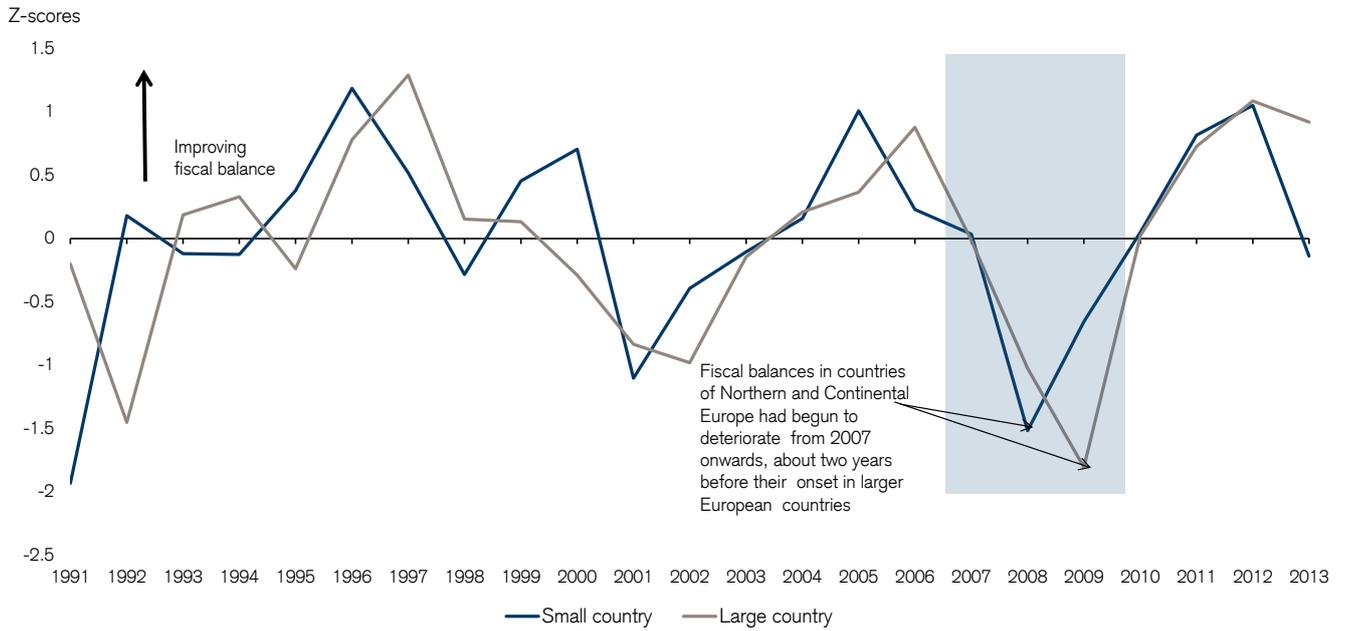
⁵ Government expenditure (% of GDP), structural fiscal deficit (% of GDP), non-performing loans (% of total loans), bank capital to assets ratio (%), bank liquid assets to total ratio (%), foreign direct investment (% of GDP), foreign portfolio investment (% of GDP), equity market capitalization (% of GDP), foreign exchange reserves (% of GDP). With the exception of household debt and FX reserves, the World Bank Development Indicators database is used as a source for all variables.

⁶ We color code the table and assume a signal when a cell is colored. Cells are colored red when the variable is at -0.5 or more standard deviations away from the mean. Cells are colored green when the variable is more than 0.5 standard deviations away from the mean. For each year (e.g. 1995), we count the number of red/green signals for the small countries. If the number of signals for any variable is greater than 25% for the small country sample (more than five countries), we consider it to be a leading indicator. Next we see if, in the next period, more than three (out of eight) large countries have shown the same trend in signal (red following red, green following green). If so, we assume that the small country sample has served as a lead indicator for the large countries. Otherwise, the signal is denoted as false. We consider only those variables as significant, where the number of right signals is more than wrong ones.

Figure 9

Small countries appear to lead large ones on fiscal outlook

Source: World Bank Development Indicators, Credit Suisse





Small countries and markets

In this and our previous publication on the “success of small countries,” we have looked at the economic strengths of small countries. We now examine whether this has carried over to their stock and bond markets. In the long run, we find impressive performance from small developed country stock markets.

In February of this year, we published our annual Credit Suisse Investment Returns Yearbook 2015, which contains 115 years of stock and bond market data across 23 countries. One of the features of the larger Sourcebook that accompanies the Yearbook is a focus on investment styles – principally the distinctions between large and small capitalization stocks, value versus growth, and cyclical versus defensive sectors. Yet one approach that does not appear to be prominent in the literature is to compare financial asset returns for large and small countries.

Given our conviction that small countries are very much at the fore of globalization, we examine this in some detail. We take three groups of countries – large developed (Australia, France, Germany, Italy, Japan, Spain, UK and USA), small developed (Austria, Belgium, Denmark, Finland, Ireland, Netherlands, Norway and Sweden) and small developing (Estonia, Hungary, UAE, Qatar, Slovakia, Iceland, Israel, Croatia, Latvia, Czech Rep, Portugal). For the first two, we calculate real equity and bond total returns (equally weighted across these countries) over a 50-year and 20 year-history (using the CS Investment Returns Yearbook dataset). We include the third group only in shorter-term analysis due to the obvious lack of long-term data for some of the developing countries.

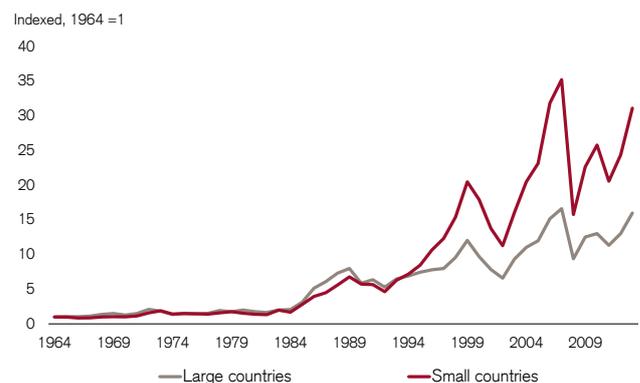
Small outperforms large

Figures 10 to 13 show the 50-year and 20-year histories for stock and bond returns, respectively, for our large and small country groupings, together with the world benchmark. Small developed country equities clearly outstrip those in large countries, although small developed country bonds have only just beaten large country ones over the past twenty years. The

Figure 10

In the long run small countries appear to have outperformed – 50 years

Source: DMS database, Credit Suisse / IDC



above trends likely reflect the higher level of growth attained by small countries throughout this period of globalization⁷.

If we look at a shorter time frame, we can see that also in the past five years, small developed country stock markets have outperformed large country stock markets by close to one percentage point a year. Yet there is a striking difference (see

⁷ Large developed (France, Germany, Japan, UK, USA, Spain, Italy, Australia), small developed (New Zealand, Hong Kong SAR, Singapore, Switzerland, Ireland, Belgium, Sweden, Denmark, Finland, Austria and Norway) and small developing (Estonia, Hungary, UAE, Qatar, Slovakia, Iceland, Israel, Croatia, Latvia, Czech Rep, Portugal).

Figure 14) in the relative performance of small developed countries and small developing countries over the past five years. Clearly, the latter have found it more difficult to benefit from the global recovery following the 2008 crisis.

If we focus on profitability, we can see that small developed markets have better returns. They earn a CFROIC® (cash flow return on invested capital) of 8% or higher – by over three percentage points – than that for large developed markets (ex-USA, Figure 15). Small developing markets instead show a CFROI similar to that of larger countries ex-USA (just above 5%). Note that the effect of excluding the USA in the large country sample is two percentage points less in the overall CFROIC. Higher CFROIs show a more efficient use of capital and over time should translate into better stock market valuations. But are they?

Using our HOLT® database for this purpose, we are able to compare the relative valuation of small developed markets and small developing markets relative to the larger group.

Figure 12
Small country bond performance versus large for the past 50 years

Source: DMS database, Credit Suisse / IDC

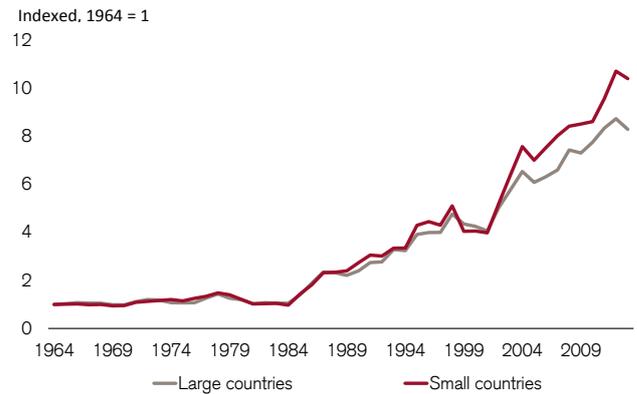


Figure 13
Small country bond performance has held in past 20 years

Source: DMS database, Credit Suisse / IDC

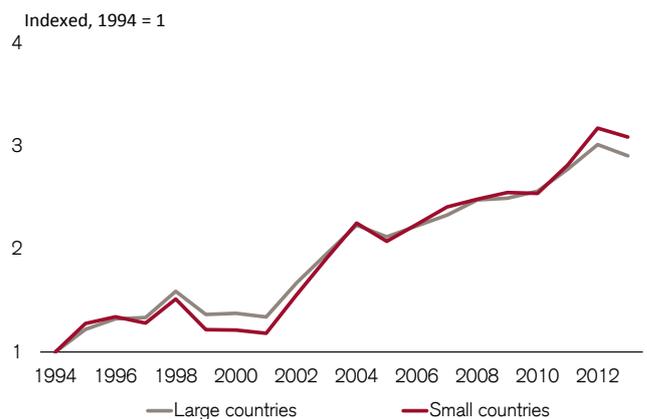


Figure 11
Small country equity performance has held in past 20 years

Source: DMS database, Credit Suisse / IDC

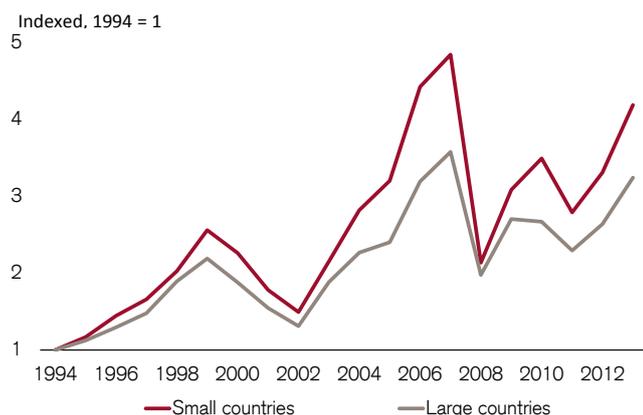


Figure 14
Small developed country equities just ahead of large over the past five years

Source: DataStream, Credit Suisse / IDC

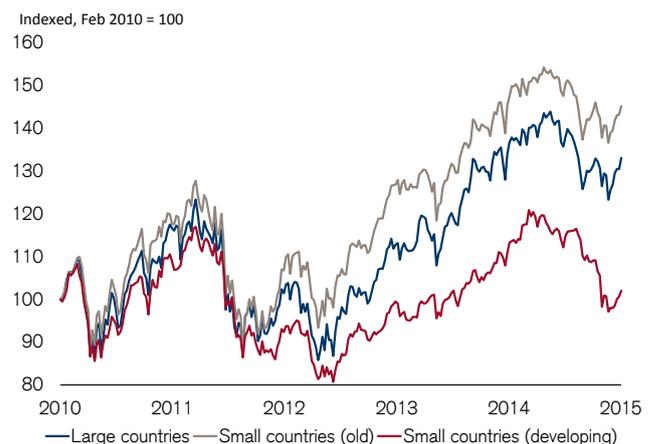


Figure 15

Small developed countries have higher CFROI than large developed ex USA

Source: HOLT, Credit Suisse

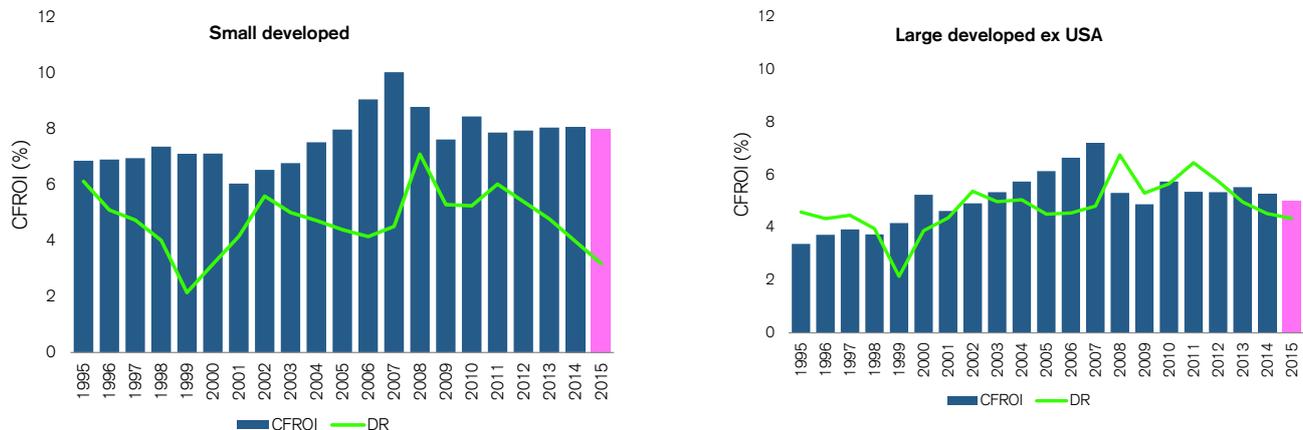


Figure 16

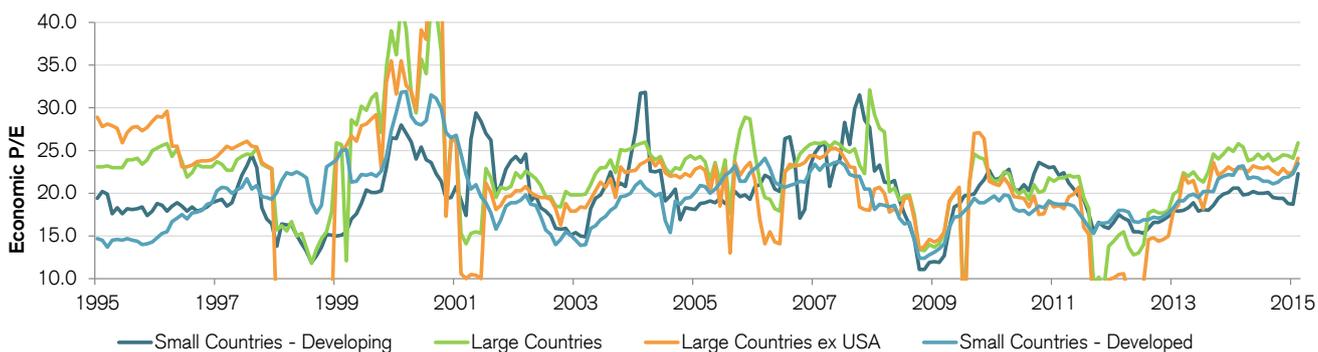
HOLT valuation metrics: Price/Book value

Source: HOLT, Credit Suisse



HOLT valuation metrics: Economic P/E

Source: HOLT, Credit Suisse



Using price to book valuation metrics, we can see that small developed countries trade at 1.9 times, a premium to both the large countries' sample – 10% – and particularly large countries ex-USA – 46%. The same does not apply to small developing countries, which trade at a price to book value of just 1.1 times. Based on HOLT economic P/E ratios (defined as enterprise value to HOLT net cash flows), large countries trade at a slight premium over small countries – both developed and developing – 26 times for large countries, 24 times for small developed countries and 22 times for small developing countries (see Figure 16).

Does volatility matter?

Volatility is an important consideration, and while it has moderated for all three country-based groups in recent years (Figure 17), the volatility of small country markets is historically greater than for larger ones (by 1% on average if we compare small developed countries to large ones). If we adjust for volatility using Datastream indices, the comparative adjusted returns remain higher for small developed countries compared to large countries (Table 3).

Table 3

Risk adjusted returns

Source: Datastream, Credit Suisse

	Large countries	Small countries (old)	Small countries (developing)
20 year	0.32	0.37	Data not available
9 year	0.08	0.11	-0.02
5 year	0.33	0.46	0.06

One reason for the apparent outperformance of small developed country indices versus large ones may be sector composition. As a next step, we uncover the sector composition of small country markets. We find that financials and industrials are the biggest sectors in the small developed country sample (Figures 18a and b), with financials having an even greater representation in small developing country markets (29%). In small developing countries, the telecommunications and utilities sectors have a relatively meagre representation.

Figure 17

Volatilities have compressed in recent years

Source: DataStream, Credit Suisse / IDC

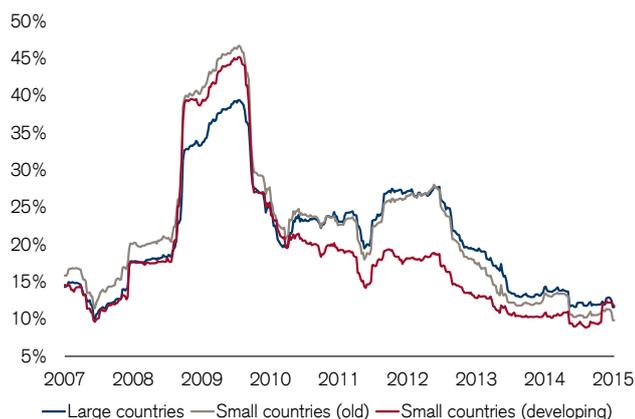


Figure 18a

Sector composition in old small countries (developed)

Source: World Bank, Credit Suisse

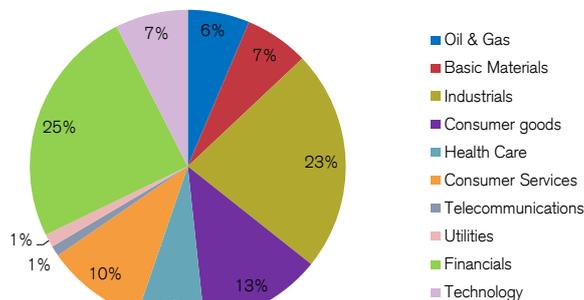


Figure 18b

Sector composition in old small countries (developing)

Source: World Bank, Credit Suisse

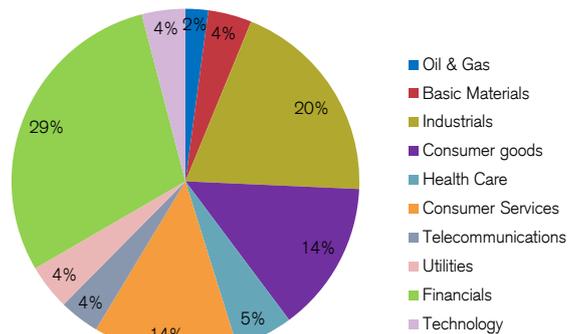


Figure 19

Small country sector weight-adjusted performance for MSCI AC World

Source: DataStream, Credit Suisse / IDC



Table 4

Small developed countries relatively highly correlated (1990–2014)

Source: Datastream, Credit Suisse

Old Small	Ireland	Austria	Sweden	Belgium	Norway	Finland	Denmark	NZ	HK SAR	Singapore	Switzerland
Ireland	1.00	0.66	0.64	0.70	0.61	0.51	0.65	0.46	0.42	0.47	0.64
Austria	0.66	1.00	0.61	0.72	0.68	0.49	0.69	0.50	0.44	0.51	0.65
Sweden	0.64	0.61	1.00	0.69	0.69	0.72	0.67	0.48	0.53	0.54	0.70
Belgium	0.70	0.72	0.69	1.00	0.66	0.54	0.72	0.47	0.47	0.52	0.76
Norway	0.61	0.68	0.69	0.66	1.00	0.56	0.69	0.51	0.47	0.54	0.64
Finland	0.51	0.49	0.72	0.54	0.56	1.00	0.56	0.40	0.45	0.45	0.58
Denmark	0.65	0.69	0.67	0.72	0.69	0.56	1.00	0.47	0.47	0.51	0.67
NZ	0.46	0.50	0.48	0.47	0.51	0.40	0.47	1.00	0.47	0.51	0.46
HK SAR	0.42	0.44	0.53	0.47	0.47	0.45	0.47	0.47	1.00	0.74	0.47
Singapore	0.47	0.51	0.54	0.52	0.54	0.45	0.51	0.51	0.74	1.00	0.50
Switzerland	0.64	0.65	0.70	0.76	0.64	0.58	0.67	0.46	0.47	0.50	1.00

In order to model how sector bias might drive small country returns, we have taken the broad MSCI AC World Index and rebalanced its performance based on the sector weighting profile that our small developed country profile had at the beginning of each of the last nine years. This suggests that, at least in recent years (Figure 19), the sector effect has played a role in driving small developed country performance. Over the last nine years, one third of the annual excess return of small developed countries relative to large developed countries is explained by different sector weightings.

Diversification is another important issue. Within the small country universe, using data going back to 1990, we find a relatively high degree of correlation between the stock markets in countries that belong in the small developed country group. The average pairwise correlation across our 11 small developed countries is 0.57, with New Zealand generally having the weakest correlation to other small states, while Switzerland has a generally high correlation with other developed small country markets (Table 4). In contrast, we found much lower (average pairwise correlation of 0.45) between small developing country markets. Both, however, show lower correlations than those we observed over the same period for the stock markets in our large countries sample: 0.63.

Companies in small developed countries

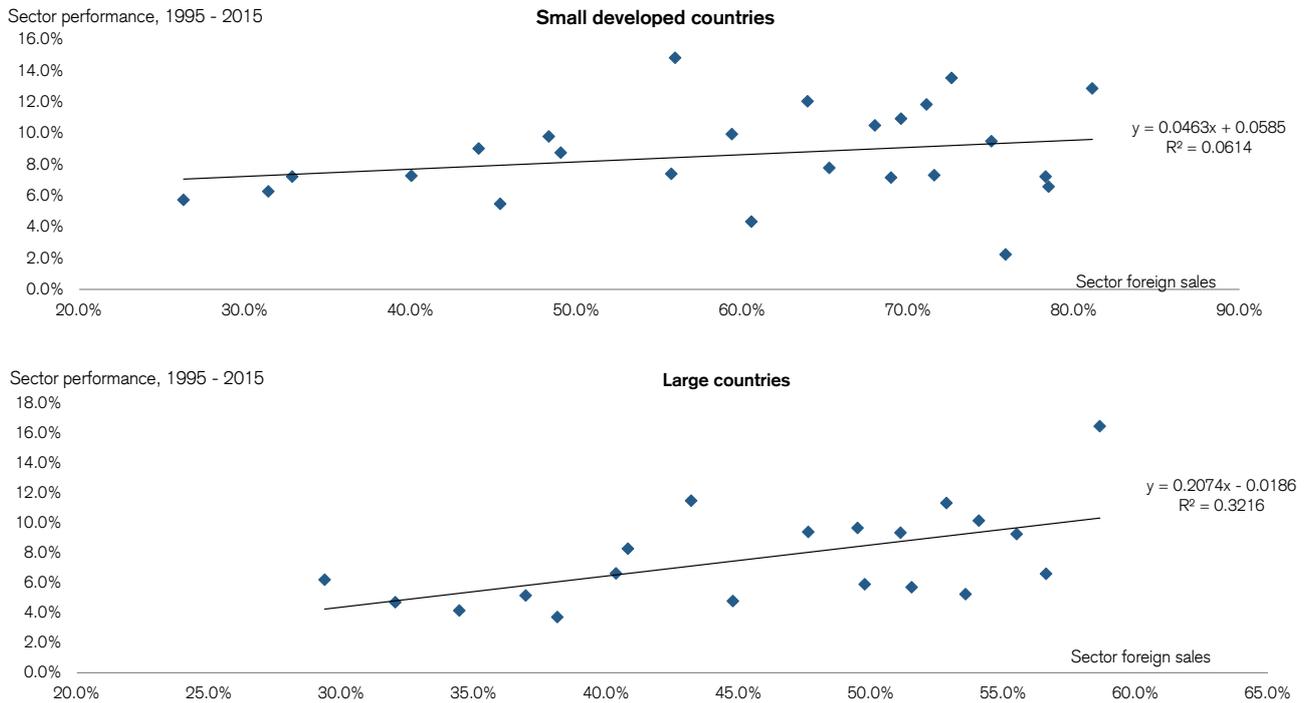
To go one step further in our analysis, we decided to examine how different types of companies have performed in small developed countries. What we wanted to test is the effect of “small countries” on domestic-oriented companies and globally oriented companies. We also wanted to compare these two groups to similar ones in larger countries. Are the examples of country export “champions” such as Novartis or Ericsson in small countries an exception or do they support a more general trend?

For this purpose, we use our HOLT database and the Worldscope database, which gives us access to company data as far back as 1995. In order to avoid survivorship/hindsight bias, we construct five baskets of companies across our small developed country universe each year on the basis of how much of total sales is driven by “foreign sales.” We do the same for the larger country sample. We also undertake several controls for a potential sector or country effect due to the small sample size.

Figure 20

Sectors: Export orientation and performance

Source: DMS database, Credit Suisse / IDC



In both large markets and small developed markets, there is a positive correlation between how export-oriented a sector is – in terms of “foreign” sales – and the relative cumulative 10-year price performance (Figure 20). This should not surprise, as with the increased globalization of the world economy, export companies have been able to reach a larger and larger client base.

The relationship is more significant for large countries than for small developed countries. This might be explained by the fact that exporters in large markets have in most case the advantage of serving not just the “global” markets, but also a

large “domestic” market, allowing for lower operating costs (marketing, distribution, etc.).

Dissecting this analysis first on sector basis, we can see that in the case of large countries, tobacco, beverages and oil show up as outperformers relative to the large markets’ composite performance (Figure 21). For large markets, these sectors show “foreign” sales in the 54%–59% range. Conversely, among the more domestically oriented sectors – “foreign” sales of 17%–25% – only retailers and financials show better performance than the markets’ composite performance.

If we do the same for small developed countries, we find

Figure 21

Exporting vs domestic sector: annualized performance for large economies (1995–2015, market capitalization weighted)

Source: DMS database, Credit Suisse / IDC

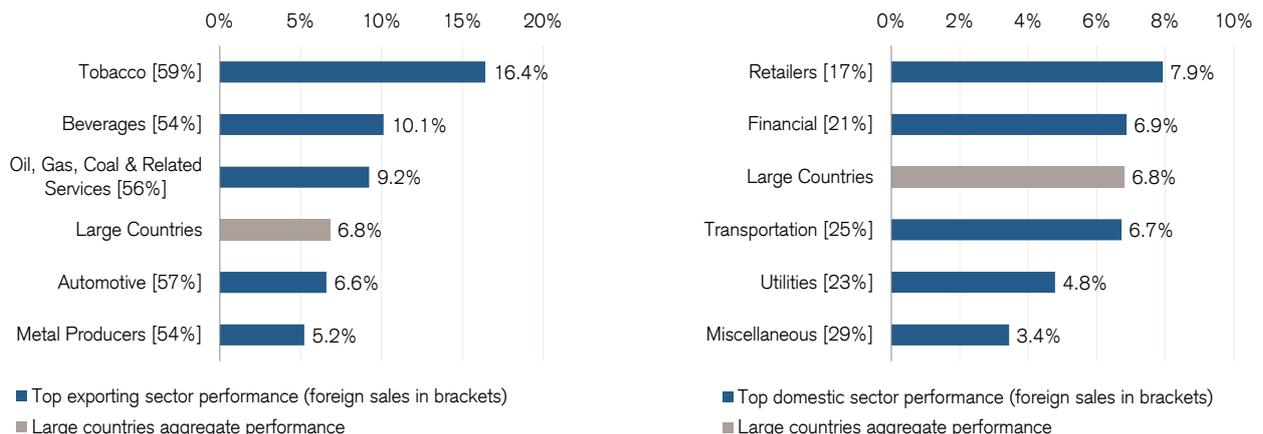
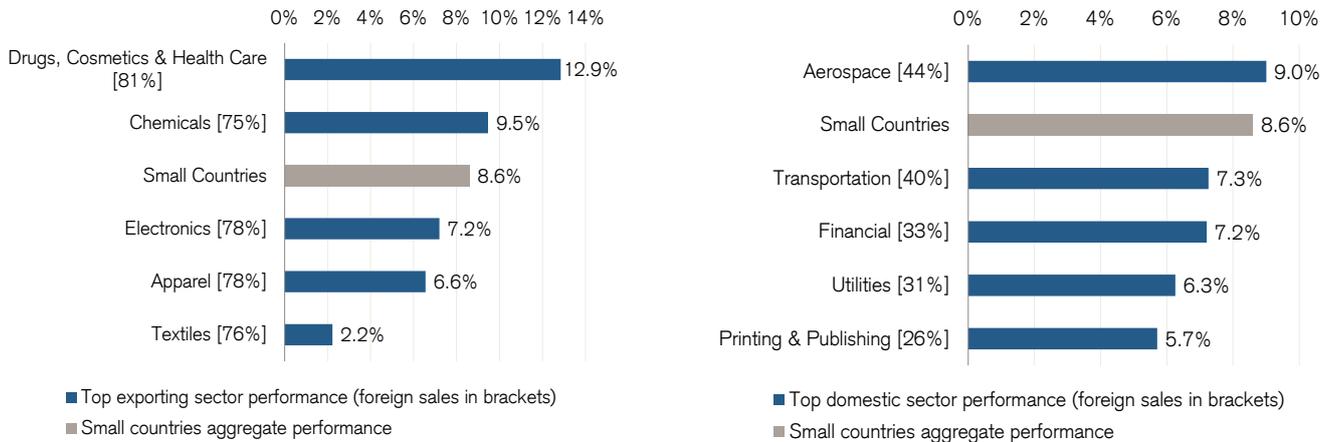


Figure 22

Exporting vs. domestic sector: annualized performance for small economies (1995–2015, market capitalization weighted)

Source: DMS database, Credit Suisse / IDC



that the export sectors that outperform the composite index of the small developed countries are in a higher value-added category and require higher R&D spending (Figure 22). It is also noticeable that, in the case of small countries, the range of “foreign” sales we need to consider is much higher: between 75% and 81%. These are companies where foreign markets are significantly more important than the domestic ones.

If we now focus on the countries rather than the sectors and start with the larger countries (see Figure 23); we can see that there is not a big differential in the performance of export versus domestic-oriented sectors either on a market cap weighted basis or an equal-weight basis. In the USA, Japan and Germany, export-oriented companies are consistently better performers. This could be due to the dominance of these three markets in tech and engineering, both requiring high levels of R&D.

For the small developed country sample (Figure 24), exporters outperform domestic-oriented stocks on an equal-weighted basis, but the opposite is true on a market cap weighted basis. These markets tend to have fewer stocks and large companies can distort the general trend when using market cap weighted data. Again we should conclude that there is not much differ-

ence. Yet, averages might be misleading, particularly in this case. Switzerland and Belgium are the only two countries that show exporters outperforming domestic-oriented companies on both market cap weighted and equal-weighted bases. Denmark and Sweden are the only ones where domestic companies outperform exporters on both bases.

Our view, however, is that to identify and assess general trends for smaller countries and markets, we need to look more on an equal weighted basis in order to avoid potential distortions induced by a few large market cap stocks. In this case, exporters outperform domestic companies by 1% over ten years. It is also interesting to notice that this is also the case in seven out of the nine countries in our sample. Conversely, for our sample of large countries, only three out of eight show exporters outperforming domestic-oriented stocks. In Table 5, we show a list of some of the leading export companies for both the small developed and large country samples. The companies in this table are those that rank in the top HOLT quintile score, have market cap higher than USD 3 billion, have foreign reserves of at least 30%, and have a neutral or positive recommendation under our Investment Banking rating system.

Figure 23

Exporters vs. markets: Annualized performance for large economies (1995–2015)

Source: DMS database, Credit Suisse / IDC

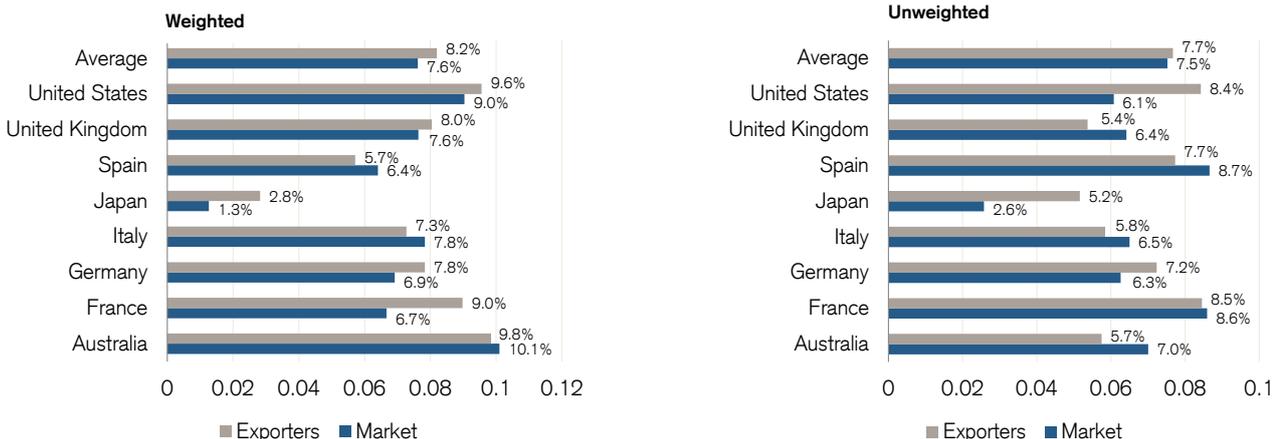


Figure 24

Exporting vs. domestic sector: annualized performance for small economies (1995–2015)

Source: DMS database, Credit Suisse / IDC

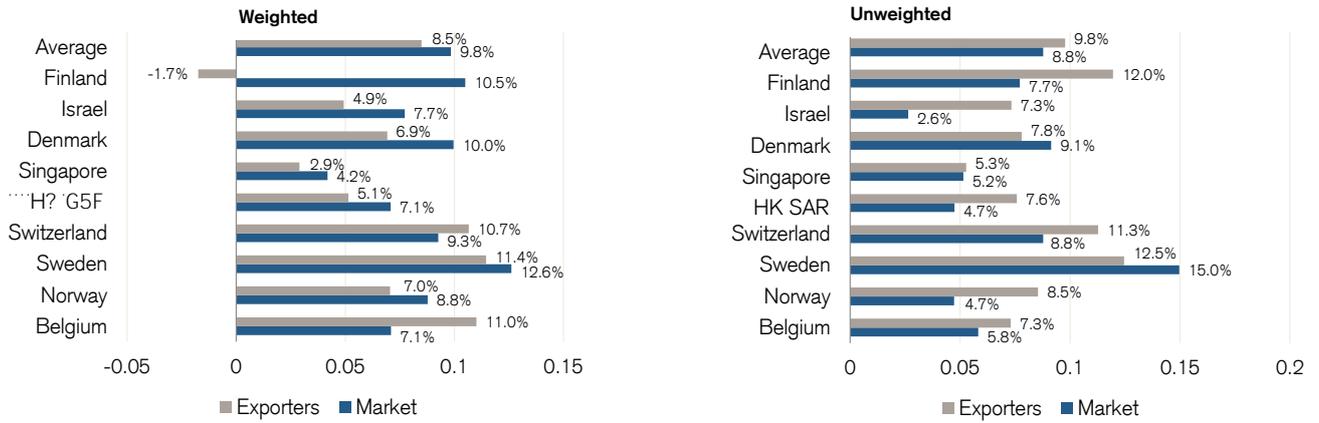


Table 5

Selected export success stories; large and small developed countries

Source: Datastream, HOLT, CS research

	Company	Country	GICS sector	Foreign sales (%)	Equity performance (CAGR)	
					Last 5 years (%)	Relative to local market (%)
SMALL DEVELOPED	Taro Pharm. Ind.	Israel	Health care	97	65	65
	Galaxy Entertainment Gp.	Hong Kong SAR	Consumer discretionary	97	60	54
	Smurfit Kappa Group	Ireland	Materials	71	30	17
	Chr. Hansen Holding	Denmark	Materials	100	28	14
	Novo Nordisk 'B'	Denmark	Health care	76	28	14
	Assa Abloy 'B'	Sweden	Industrials	94	26	14
	China Gas Holdings	Hong Kong SAR	Utilities	100	25	19
	Paddy Power	Ireland	Consumer discretionary	48	24	11
	Ryanair Holdings	Ireland	Industrials	89	24	11
	Cheung Kong Infr. Hdg.	Hong Kong SAR	Utilities	35	21	14
	Anheuser-Busch Inbev	Belgium	Consumer staples	90	21	10
	Kone 'B'	Finland	Industrials	56	20	16
	Sampo 'A'	Finland	Financials	52	19	15
	Atlas Copco 'A'	Sweden	Industrials	70	18	7
	Sika 'B'	Switzerland	Materials	100	18	7
	UPM-Kymmene	Finland	Materials	90	15	11
	Great Eastern Hdg.	Singapore	Financials	41	14	7
	Aryzta	Switzerland	Consumer staples	38	12	1
	Telenor	Norway	Telecommunication	73	11	10
	DBS Group Holdings	Singapore	Financials	31	10	4
	Solvay	Belgium	Materials	99	9	-1
	Umicore	Belgium	Materials	97	7	-4
	Alfa Laval	Sweden	Industrials	97	6	-5
	Edp. Energias De Portugal	Portugal	Utilities	48	5	11
	ABB Ltd N	Switzerland	Industrials	66	2	-9
	Sembcorp Marine	Singapore	Industrials	91	-2	-9
Vestas Windsystems	Denmark	Industrials	49	-4	-18	
Erste Group Bank	Austria	Financials	34	-9	-7	
Raiffeisen Bank Intl.	Austria	Financials	40	-20	-19	
LARGE	Continental	Germany	Consumer discretionary	76	39	29
	Apple	United States	Information technology	62	33	18
	Prudential	United Kingdom	Financials	69	30	22
	Safran	France	Industrials	79	26	20
	WPP	United Kingdom	Consumer discretionary	34	21	14
	Daimler	Germany	Consumer discretionary	100	20	11
	Softbank	Japan	Telecommunication	40	19	12
	CSL	Australia	Health care	86	19	14
	Toyota Motor	Japan	Consumer discretionary	67	14	7
	Vodafone Group	United Kingdom	Telecommunication	95	14	6
	L'Oreal	France	Consumer staples	89	13	7
	Johnson & Johnson	United States	Health care	53	13	-2
	Allianz	Germany	Financials	44	12	2
	General Electric	United States	Industrials	52	11	3
	Pernod-Ricard	France	Consumer staples	65	9	3
	Mitsubishi UFJ Finl.Gp.	Japan	Financials	33	8	0
	Enel	Italy	Utilities	58	1	0
	Iberdrola	Spain	Utilities	91	0	-3
	Repsol YPF	Spain	Energy	45	-1	-5
	Assicurazioni Generali	Italy	Financials	54	-3	-4
Banco Santander	Spain	Financials	37	-5	-9	
BHP Billiton	Australia	Materials	94	-8	-12	
Unicredit	Italy	Financials	37	-17	-18	

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