FT.com FINANCIAL TIMES

Close

Building success

Print

By David Oakley
Published: November 6 2009 16:48 | Last updated: November 6 2009 16:48

Emerging markets have, it is generally considered, had a good financial crisis. So good, in fact, that for many investors, they are the future. Emerging market economies are growing faster than those of the developed world, they are not tainted by the problems of subprime mortgages or toxic assets, while their banks remain largely strong – without the high leverage that undermined many western institutions.

More significantly, it was emerging markets, most notably China, that pulled the world back from the brink of financial meltdown – not the US, the world's largest economy. "We are no longer in a world driven by the US, but one driven by the emerging markets," says Stephen King, chief economist at HSBC.

This is a dramatic reversal from the past – when financial crises hit the developing markets hardest, usually because the crises were created by the countries' own poor economic management. The Mexican "tequila crisis" of 1994-95, the Asian and Russian crises of 1997-98 and Argentina's debt default of 2001 all fit into this category.

This time, however, the emerging markets have proved much more resilient, as prudent policymaking helped them to navigate the financial storms far more effectively than many industrialised economies.

This success has turned asset allocation on its head, with some emerging markets considered safer places to invest than those of the developed world. Brazil, for example, with its sound economic framework, is arguably less likely to default than Italy, with its debt-to-GDP ratio of more than 100 per cent. Some commentators even say the countries' improvement has been so great that the term "emerging markets" is now obsolete.

Hugh Hunter, chief executive of Blackfriars Asset Management, an emerging market specialist within BNY Mellon Asset Management, says: "Many emerging markets are a similar risk to those of developed markets. You are investing in something that is no more likely to default, yet you have much better prospects for growth."

Ahmet Bekce, an emerging markets banker at Citigroup, adds: "There is no doubt that the emerging world is where the growth is. Many of these markets are no longer the big risks they once were because of accumulation of capital within emerging market economies that took place over the past 10 years and sensible economic management."

The powerhouse behind the emerging markets is, of course, China. Last year's $568bn stimulus package was the catalyst for the rebound in emerging markets equities, which rallied months before those in the developed world.

But the other Bric nations – Brazil, Russia and India, as well as China – have also enhanced their reputation. Russia, in spite of being the weakest of the four, is expected to see its economy grow again next year, helped by rising oil prices.

This economic success has been mirrored on the political stage, with the Group of 20 nations replacing the Group of Seven as the primary international policymaking forum.

So what does this growing economic and political clout mean for investments? In short, according to bankers, an increasing number of funds will switch money into these faster-growing markets, and not least because they are still only a small part of the investment universe.

Emerging market funds under management globally have increased to $563bn, from $64bn a decade ago, according to EPFR Global, the financial data provider. But this is still small compared with the $4,400bn of assets under management in the developed world. Further, emerging market stocks make up only 11 per cent of the FTSE All-World index, while the average pension fund allocates a mere 5 per cent of its portfolio to emerging markets – in spite of the fact that such markets make up about 30 per cent of world GDP.

Hunter says: "Without question, this is an asset class that continues to expand and is structurally underinvested by the majority of longer-term investors. This is an asset class that has become more mainstream and will continue to do so over the next few years."

King adds: "The emerging markets have unleashed a productivity surge that is unprecedented in economic history. This is because of the improvement in these economies of such things as healthcare and technology. They also have younger economies that should see this improvement in productivity continue."

However, fund managers warn investors against pursuing a blanket policy of pumping money into emerging market

assets in the hope that economic growth will automatically deliver strong returns. They insist that investors must still be selective – not least because the emerging markets cover a very broad group, with vastly different economic profiles and investment opportunities.

The small, open economies of Asia, such as Taiwan, Singapore and Malaysia, look a good bet as their flexible economies have flourished with the help of their powerful Chinese neighbour. Their reliance on international trade, however, remains a concern, particularly if the global recovery falters.

The Middle East, which includes the United Arab Emirates, Bahrain, Saudi Arabia, Kuwait and Qatar, could also offer rich pickings, particularly if oil prices continue to hold up. These markets have some of the wealthiest investors in the world, although their regulatory and legal frameworks remain a concern for some investors.

In South America, Brazil continues to be the dominant economic power. Argentina and Venezuela, however, could also offer good value for the braver investor in an improving economic climate. Central and eastern Europe fall into the same category, although some of these markets remain unstable, and reliant on international support to keep them afloat.

Africa is perhaps the greatest unknown. The continent's markets are among the poorest and most underdeveloped in the world. While Nigeria and South Africa could offer big returns, equally, they could fail to live up to expectations.

"Emerging markets cover a whole range of economies, so you have to look carefully at the different ones," warns Bekce. "As a group, they will grow more quickly than the developed markets, but that does not necessarily mean they are a very homogenous group in terms of their risk-return dynamics."

Hunter adds: "Valuations are the best way to look at the various emerging markets. It is still about looking for cheaper and more attractive stocks or assets. However, in general, it is fair to say that the future of finance and economics is the emerging markets."

David Oakley is the FT's capital markets correspondent

Copyright The Financial Times Limited 2010. Print a single copy of this article for personal use. Contact us if you wish to print more to distribute to others.

"FT" and "Financial Times" are trademarks of the Financial Times. Privacy policy | Terms
© Copyright The Financial Times Ltd 2010.