

ASSET ALLOCATION MASTERCLASS – KEY TAKEOUTS

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The Emerging Markets Masterclass provided participants with the opportunity to explore the Emerging Markets story and the different options available to capture some of the investment.

In fact, the opportunity in Emerging Markets was touted by almost every presenter at both the Masterclass and the subsequent two-day PortfolioConstruction Conference presenter. They were unanimous in their conviction that Emerging Markets would provide faster growth than the developed economies looking forward. Some, such as Chris Watling, CEO of Longview Economics, suggested that this was the Emerging Markets century and that all investors would need to rethink how that will look in terms of our portfolio investments.

My key takeouts from the Masterclass are discussed below but can be broadly summarised as:

- Emerging Markets are now an attractive investment option;
- Emerging Markets are not a homogenous asset class – each region has different risk and return factors that must be considered in the context of a portfolio; and,
- Access is important – there are numerous different offerings available to retail investors, each with individual merit, but it is important to do your homework and choose wisely.

As a back drop to the day, Watling painted the picture for the status of Emerging Markets and why they are worth considering in a diversified portfolio. While historically Emerging Markets have been riskier, his view was that this is likely to change. He cited several factors including:

1. More policy risk lies in developed markets due to the Global Financial Crisis and the imperative that Governments stabilise developed economies;
2. There is less recession risk in Emerging Markets;
3. The industrialisation dynamic still has a way to go in Emerging Markets;
4. Emerging Markets are now in a much stronger fiscal position than in past economic cycles. Since experiencing significant hardship during the series of Emerging Market crises between 1997 and 2001, these economies have paid down debt, increased savings and built reserves. Hence they now have structural economic strength, significant foreign exchange reserves, growing revenues from expanding global demand and stronger currencies;
5. Emerging Markets have outperformed developed markets since the lows of the Asian financial crisis in the late 1990s.
6. Emerging Markets for the most part have a far better demographic profile than developed nations, with a much higher proportion of the population working and therefore productive;
7. Emerging Markets have a low cost, rapidly expanding pool of labour which is producing an increasing number of consumers;
8. Government stimuli now being applied to these economies will result in further economic strength;
9. There is increased corporate transparency and a positive impact from Government-led reforms in these markets; and,

10. Returns are likely to be much better in Emerging Markets compared to developed markets globally going forward.

Uniquely, the Masterclass included presentations by the Ambassadors or their representatives of the four BRIC nations, Brazil, Russia, India and China. What was very interesting about these presentations was the perspective provided by each on their country and culture. The insights they gave on their countries were fascinating.

- Mr Fernando de Mello Barreto, Ambassador of Brazil to Australia, represented by economic adviser, Alberto Fonseca, focussed on Brazil's renewable sources of energy. In particular, ethanol production was cited as having the potential to provide Brazil with even more impressive growth than has been seen in the past five years;
- From the Russian Ambassador Mr Alexander V. Blokhim, we heard about Russia's Government initiatives to encourage investment and development including legislative improvements, setting up Special Economic zones and a Foreign Investment Advisory council. Russia views itself as being in a unique geographical position between Europe and the US with prospective growth available from resources, tourism and infrastructure.
- Smt. Sujatha Singh, High Commissioner of India to Australia, represented by her deputy, V K Singh, focussed on India as an engine of economic growth. India is in the fortunate position of having a large pool of English speakers, abundant resources, and a robust legal and democratic system. However, it is probably further up the curve than Brazil or Russia, as 40% of its GDP is now accounted for by two way trade (in contrast with Brazil, where exports are only 14% of GDP).
- Finally we heard from Mr Zhang Junsai, Ambassador of the People's Republic of China to Australia. The Chinese economy has slowed, there is over-production, unemployment is increasing, but a stimulus package has generated notable results with foreign trade having increased for five consecutive months. As the Chinese put it, "It has been a chilly winter, followed by spring."

In the afternoon, the Masterclass focused on different ways to access the Emerging Markets opportunity. We heard from a top down manager, a bottom up manager, a specialist East European manager, an Emerging Markets Infrastructure specialist, an Emerging Markets Fund of Funds manager. The overwhelming takeout from this segment of the Masterclass was that not all opportunities in Emerging Markets are equal.

This was particularly emphasised when possible issues with investments in these markets were discussed. There are many possible issues that may arise in this segment. These include:

- Lack of structural legal reforms or government regulation which have the potential to dampen opportunities;
- Potential political instability;
- Access to commodities/raw materials for production; and,
- Quality of stockmarkets and accuracy of benchmarks.



Summary

To summarise the key takeouts from this Masterclass, Emerging Markets definitely do warrant a further look for investors post the Global Financial Crisis for the above mentioned reasons, but it is important that all participants do their research and make sure they are comfortable with the different ways of accessing this market before making an allocation to a diversified portfolio.

The facts on Emerging Markets are compelling. Emerging Markets do seem to be the “new reality”. The challenge is to make the investment in attending a Masterclass translate into outperformance for clients. Fewer than 1% of portfolios are invested in emerging markets even though most attendees at the Masterclass had a view that this asset class will outperform.

Adding Emerging Markets to a global portfolio opens an investor up to a much broader opportunity set and provides exposure to the rapid social, economic and financial development underway in these countries. The importance of Emerging Markets is increasing and is likely to continue to do so.