Emerging Markets Report

News & Commentary

Emerging-market strategies and picks for 2013; Experts make their picks for new year's top emerging markets

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SAN FRANCISCO (MarketWatch) — Emerging-market investors will need to look beyond the usual heavyweights known as the BRICs if they want to ensure healthy returns in 2013.

The slowdown in China presented a challenge in the recovery for developing markets this year — particularly for the group of larger emerging nations, which are Brazil, Russia, India and China — but overall they've managed to recover much of 2011's loss.

As of Monday, the iShares MSCI Emerging Markets index fund was poised for a 13% gain for the year. That's a big improvement from the 19% loss it suffered in 2011, though still below 2010's more than 16% climb and its 69% return in 2009. Read: Emerging markets take 2011 hit; 2012 may be better.

Based on data covering iShares MSCI exchange-traded funds and notes on specific emerging-market countries, Turkey, Thailand, Mexico and Hong Kong are among the best performers this year.

The iShares MSCI Turkey Investable Market Index Fund trades nearly 60% higher for the year to date, while iShares MSCI Thailand Investment Market Index Fund readies for a gain of more than 30%. The iShares MSCI Brazil (Free) Index Fund has lost 7% for 2012.

BRICS and non-BRICs

From Asia and Africa to Eastern Europe and Latin America, experts see opportunities for emerging markets next year in certain BRICs and non-BRIC nations, for lots of different reasons.

Emerging markets “may be a handy way to refer to a group of countries constituting a generally recognized asset class, but the group is far from monolithic,” said Scott Klimo, deputy portfolio manager at Saturna Capital, pointing out that they present widely differing returns, levels of development, economic drivers and opportunities to invest.

Klimo, who’s firm is an adviser to the Amana Funds, including the Amana Developing World Fund , sees opportunities in specific regions and countries. He believes that “emerging markets provide more attractive investment candidates than most of the developed world, the United States excepted.”

The year has offered “a unique investment climate” — a good year for some BRICs, but a great year for non-BRIC countries such as the Philippines and Turkey, according to Mark Williams, who teaches risk management at Boston University. Read: Indonesia and Philippines come of age.

As an entire group, “the BRICs underperformed for the level of risk taken” by investors in 2012, he said, suggesting that investors focus on picking the most promising non-BRICs to “avoid a repeat of 2012 underperformance.”

Investment strategies

Finding a good investment strategy will be well worth it given the market’s outlook.

“The three key ingredients driving the [emerging] markets are still in place: fast economic growth, high foreign reserves and low government debt,” said Mark Mobius, executive chairman of Templeton Emerging Markets Group, a unit of mutual-fund giant Franklin Resources Inc. “These factors mean that emerging markets will continue to be in a strong position.”

Mobius added Templeton Emerging Markets Group picks stocks instead of countries, and evaluates stocks based on their potential for growth and their price in relation to their current and future earnings.

On that basis, “we are finding the best bargains in China, Russia, India, Thailand, Nigeria and Vietnam,” he pointed out.

When making a choice among the developing nations, **Usha Haley**, author of “Subsidies to Chinese Industry: State Capitalism, Business Strategy and Trade Policy,” said it’s best to “stay with countries with the largest domestic-market potential and some valid indication of market reform.”

Her picks include BRICs as well: Brazil and India. Both “have some transparency and so it is easier to gauge the actual reform,” she observed.

China will continue to draw investments but unless the country enhances transparency, “assessing domestic companies’ operations and business environments remains a guessing game,” noted Haley, who is also professor of international business at Massey University in Auckland, New Zealand.

If investors “consider a country’s growth rate and its economic heft,” China and India are still the most important emerging economies to watch, said Ravi Ramamurti, director of the Center for Emerging Markets at Northeastern University. Brazil and Russia, on the other hand, will likely continue to disappoint investors next year because both depend too much on natural-resource exports, he added.

The BRICs may have been the four largest emerging economies, but they “never shared the distinction of being the four fastest-growing economies.”

Africa and Asia

Many of the world’s fastest-growing economies instead are in Africa and Asia.

Factors in emerging markets such as “urbanization, younger workforces and population size” will result in a rise in disposable incomes, economic activity and consumption, according to José Morales, portfolio manager of the Mirae Asset Emerging Markets Great Consumer Fund

So “in our diversified portfolios, we have put money to work in Indonesia, Thailand, Turkey and South Africa,” said Morales, whose fund mainly focuses on stocks, rather than specific countries.

Matt Lasov, associate vice president at Frontier Strategy Group, an information-services firm for emerging-markets executives, said his top five picks are all located in Southeast Asia and Africa.

His company looks for markets that are “structured to outperform even if global trade and investment continue to slow 2013.”

Lasov also said that oil prices are another leading indicator, and with crude prices likely to fall as a result of decreased demand in Europe and China, “emerging markets that rely on domestically generated demand to drive economic growth, rather than commodities exports, will benefit.”

Given those criteria, FSG’s top five emerging markets for 2013 are: Ghana, Tanzania, India, Nigeria and Bangladesh. Read: The world’s “New Tigers” lie ready to pounce.

“Africa has been a tremendous growth opportunity for our clients and that will only grow 2013,” Lasov commented, adding that the continent will also benefit from $50 billion in foreign direct investment in 2013 from multinational corporations.

In Southeast Asia, growth is driven by robust domestic demand and the region will benefit from “capital flows looking for new, higher-yielding opportunities outside of China, where companies and investors are over-allocated,” he said.

All told, opportunities in the emerging markets for the coming year are everywhere.

In the second half of this year, money started to flow back into the emerging-market areas of the globe, “suggesting that a lot of the negative headlines and uncertainty is now priced into these markets,” said Paul Attwood, portfolio manager of the Huntington Global Select Markets Fund .

“If the global economy can stabilize, political and regulatory certainty in the U.S. improves, and the onslaught of negative headlines we’ve seen this year ease,” he continued, “2013 should be a great year for investors in the emerging-markets space.”

The slowdown in China presented a challenge in the recovery for emerging markets this year, so it’s important to work up a strategy to pick the most promising developing markets for 2013.**|**103

