

# Emerging Markets

Risky to be in? Risk in ignoring?

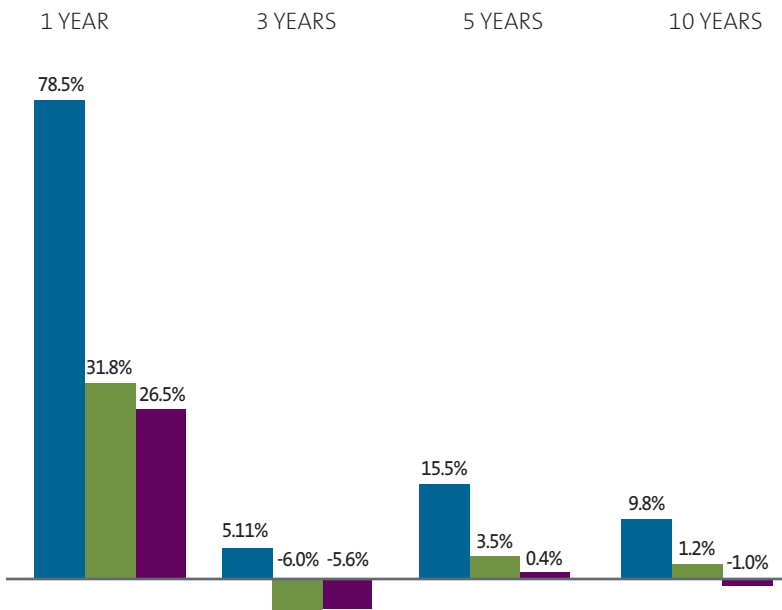
**Emerging markets** are nations with social or business activity in the process of rapid growth and industrialization. The term comprises the large economies of China, India, Russia, Brazil and Mexico, as well as the smaller economies of Vietnam, Singapore, Kuwait, Israel, Egypt, Chile, Costa Rica, Botswana, New Zealand and others. (North Korea, Zimbabwe and others lacking market economies and/or securities markets open to foreign investors, are not included in the category.) As a group emerging markets represent 80 percent of the world's population, hold 66 percent of foreign-exchange reserves and account for 50 percent of the world's gross domestic product.

The increased influence of emerging markets on total economic growth is one of the major shifts now underway in the global economy. During the financial crisis of 2008-2009, emerging markets proved less vulnerable to banking and credit bubbles than their developed-market counterparts. Partly as a result, we now foresee healthier banks and credit markets than in the past in these developing economies, along with less corporate and consumer debt, greater job demand, and greater consumption demand.

## ANNUALIZED EQUITY RETURNS

PERIODS ENDED DECEMBER 31, 2009

■ Emerging Markets<sup>1</sup> ■ Developed Markets<sup>2</sup> ■ U.S. Markets<sup>3</sup>



For investors, the term *emerging markets* signifies both a degree of risk and a corresponding potential for reward. In recent years emerging markets have provided some of the richest returns to investors in public securities. The MSCI Emerging Markets Index has returned an average of 15.5% over the five years 2004-2009, while the S&P 500 Index of U.S. stocks averaged 0.4%.

**Faster growth.** The economies of many developing nations—not just China and India—have been growing much faster than those of the EuroZone, North America and Japan, and are projected to continue growing more rapidly than the developed economies in the foreseeable future. Some observers predict, too, that the value of financial securities in emerging markets—now 27 percent of world equity market value—will surpass that of developed markets in the not-too-distant future. Other positives: emerging economies have generally cut fiscal deficits and inflation rates dramatically in the past decade; and these economies now have sizeable, and growing, middle classes. Both developments contribute to stability and strength.

<sup>1</sup>MSCI Emerging Markets Index; <sup>2</sup>MSCI EAFE (Europe, Australasia, & Far East) Index; <sup>3</sup>S&P 500 Stock Index



# Emerging Markets

*continued*

**But some higher risks.** Financial systems and securities markets in emerging economies typically lack the long records of consistent regulation and stable operation found in developed economies such as the United States, Japan, Germany, the UK, France, Canada and Australia. These afford investors significant protections. Even apart from the risks presented by untested financial infrastructures, and in some cases, economic fragility and currency volatility, emerging markets are vulnerable to political risk from regime changes, arbitrary government actions and other disruptions to financial markets.

Although the name *emerging* has an optimistic, positive ring to it, wags contend that emerging markets are those from which one cannot emerge in an emergency. If the financial crisis of 2008-2009 demonstrated the relative strength of emerging markets, the month-long market slump that began in May 2006 illustrates some of their possible comparative risks: the MSCI Emerging Market Index lost more than a quarter of its value (subsequently regained, it must be noted), while the S&P 500 Index retreated less than 7.5%. The earlier Southeast Asian economic crisis in 1997 took a particularly heavy toll on the currencies and stock markets of emerging economies

in the region. Before that, investors in emerging markets felt comparatively large shock waves from the devaluation of the Mexican peso in 1994, Iraq's invasion of Kuwait in 1990 and the global stock market crash of 1987. But many of the differences between emerging and developed markets have narrowed significantly in recent years.

**The bottom line.** Investing solely in emerging markets is not for your teen's college fund. You and even your teen may already have exposure, though. Broad-based international mutual funds often include an emerging-market component, up to as much as 40% of their investments. The levels of risk are as numerous as the emerging markets themselves, and additional severe pullbacks in these markets are virtually inevitable. But given their healthier infrastructures, emerging markets' potential for further and faster growth in an increasingly integrated, rapidly

evolving world economy compels attention from aggressive, and even cautious, investors. To minimize the risk of missed opportunities, those looking for maximum long-term capital appreciation may want to consider an emerging-market component in a diversified asset allocation strategy.

*This information is for illustrative purposes only. It is not intended to reflect specific investments or investment styles. Past performance is not a guarantee of future results. Allegheny Investments, Member FINRA/SIPC*

## PROJECTED RELATIVE ECONOMIC SIZE IN 2050

■ G7 (U.S., Japan, Germany, UK, France, Italy, Canada)

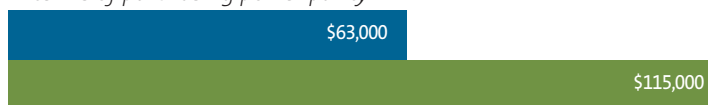
■ E7 (China, India, Brazil, Russia, Indonesia, Mexico, Turkey)

GDP in billions of dollars (2004 value)

*At market exchange rates*



*In terms of purchasing power parity*



Source: PricewaterhouseCoopers

