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Investing in Emerging Markets

The returns are high, but so is the risk.

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These days, many investors are struggling with the problem of where and how to invest their money. Anemic interest rates, unnerving volatility in the stock markets, and the scary thought of investing in the mysterious commodities markets have many investors on edge over what to do next.

As at least a partial solution to this dilemma, some investment professionals are suggesting that emerging markets should be part of every investor's portfolio. But just what do we mean by emerging markets, and why would they be good investments for most of us?

Catherine Gordon of Vanguard's Institutional Asset Management group describes emerging markets as "any country or collection of countries that are generally considered to be growing faster than other countries. They could be developing their industrial infrastructure, population could be growing, but it's just any country that's emerging from a lower developed state."

So, which countries are generally accepted as emerging markets? According to the most popular definition, the so-called BRIC countries (Brazil, Russia, India and China) are the largest. Next in size are South Korea, Mexico, Indonesia, Turkey, and Saudi Arabia.

Emerging markets are not confined to these countries or any specific regions; countries considered as emerging markets are also located in the Pacific Rim area, and South America, as well as other markets in Asia.

Proponents of investing in emerging markets can point to a period of strong returns in emerging markets. According to Vanguard data, for the 10 years ended December 31, 2009, the average return for diversified emerging-markets mutual funds was about 9%. During that same period the Standard & Poor's 500 Index had a –1% return. In the year 2009, the difference was far more dramatic: a nearly 74% average return for emerging markets, versus 26% for the S&P.

However, these figures probably serve as a good reminder that past performance is no guarantee of future performance. Since 2009, returns on emerging markets have been quite volatile, much like domestic markets.

2016 started on an especially sour note, with January 2 2016 making history as one of the worst first trading days on record for many markets around the world. Since then, volatility in domestic as well as emerging markets has been the rule rather than the exception. Still, there is no shortage of financial professionals who feel that emerging markets offer the average investor an opportunity for above average returns. Aberdeen Asset Management, one of the firms that offers an emerging markets mutual fund, expresses the belief that many of the emerging markets still have far to go before reaching their peaks.

If you're considering adding emerging markets to your investment portfolio, the easy way to do it is through a diversified emerging markets mutual fund. Among many other companies offering emerging markets mutual funds are William Blair, Templeton, Fidelity, Huntington Global, American Century, Vanguard, and Morgan Stanley.

If you decide to invest, what percentage of your portfolio should be devoted to emerging markets? As is the case with so many other investment classes, that all depends on your investment goals and your tolerance for risk.

Vanguard's Gordon cautions, "Emerging markets

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KEYPOINTS:

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- **If you're considering adding emerging markets to your investment portfolio, the easy way to do it is through a diversified emerging markets mutual fund.**
- **Experience has shown us that foreign securities tend to be more volatile than U.S. securities.**
- **In the minds of many professional investors, going global is a logical way to help diversify your portfolio and enhance your overall returns.**

typically are more volatile than more developed markets. They're subject to more risks within the market themselves, whether it's the economic risk or the political risk. We've seen some emerging markets react very badly to the results of an election or a currency crisis or a banking crisis, so they generally are considered higher-risk investments than investments in more developed markets."

Devan Kaloo, head of Global Emerging Markets, Aberdeen Asset Management, reminds us that "Investing in mutual funds involves risk, including possible loss of principal. There is no assurance that the investment objective of any fund will be achieved."

And experience has shown us that foreign securities tend to be more volatile than U.S. securities. In addition to different accounting and regulatory standards, they are also less liquid. Political risks in foreign countries are another factor to consider.

So there you have it. In the minds of many professional investors, going global is a logical way to help diversify your portfolio and enhance your overall returns. However, even the most dedicated emerging-markets fan concedes that foreign investing carries a special type of risk that must be considered when allocating investing classes in your portfolio.

If you feel that sticking a toe in foreign waters will be good for your portfolio, perhaps a small allocation, say 5 percent, may be the answer. As for me, I would consider that as the maximum figure, at least for now.

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