Emerging market investments

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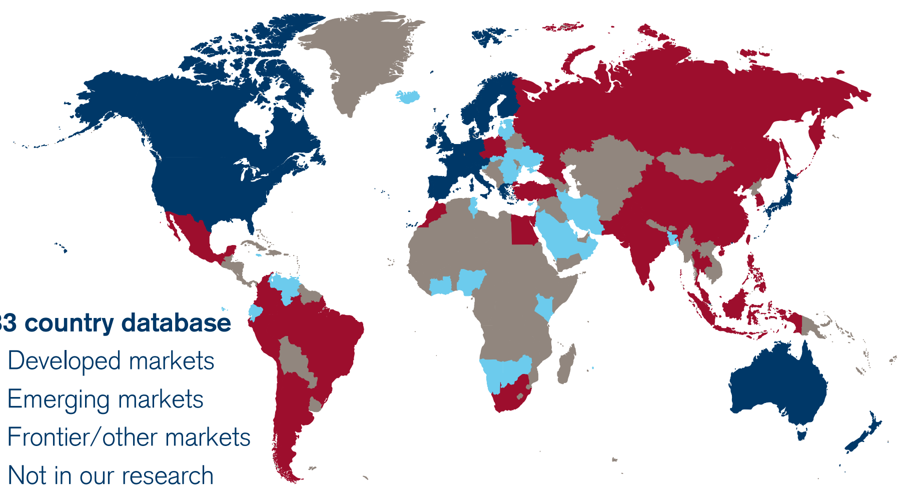
- **Why invest in emerging markets?**
- **EMs important now – and more important in future**
- **Impressive performance record and potential**
- **Less risky: no longer riskier than developed markets**
- **Valuable diversification benefits**
- **Faster economic growth means higher returns**
- **But is this a correct and balanced view?**

For presentation at “Investing for the Long Run: the investment strategy for the Government Pension Fund Global”

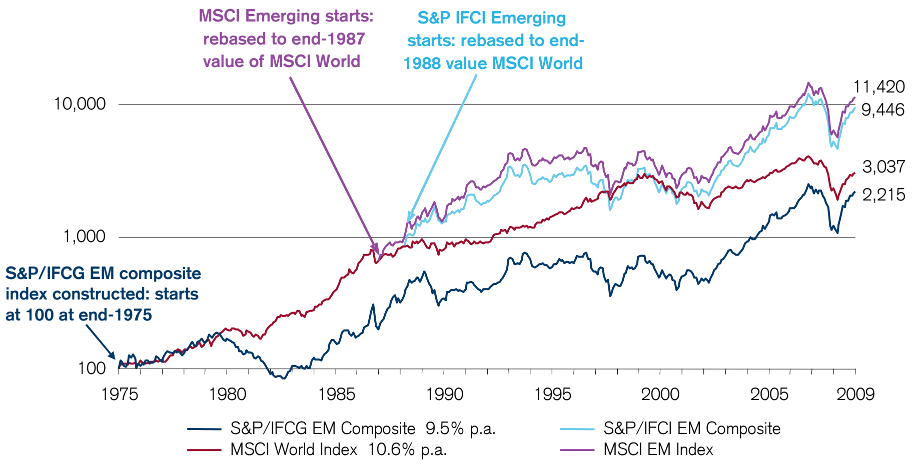
Global markets



83 country database

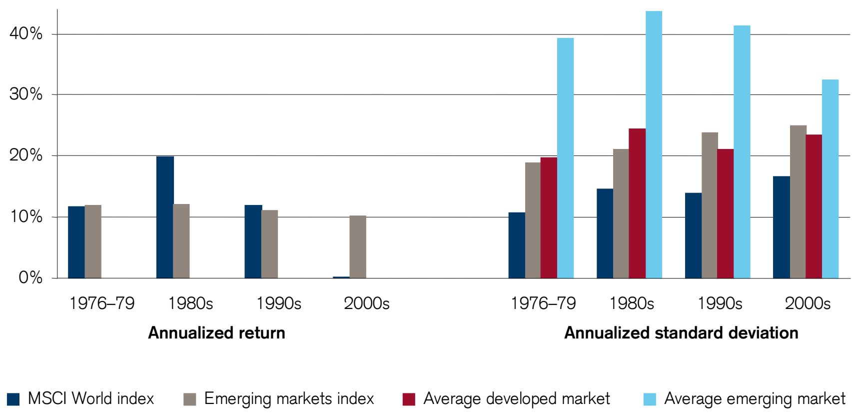
- Developed markets
- Emerging markets
- Frontier/other markets
- Not in our research

Long-term performance



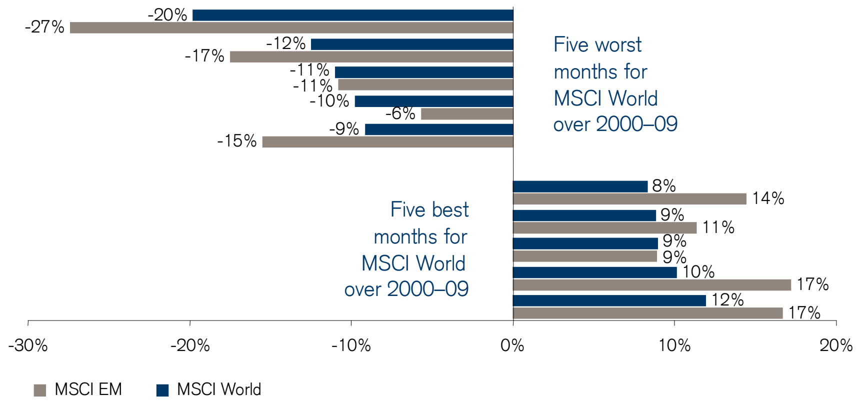
Source: MSCI Barra; S&P

Risk and return



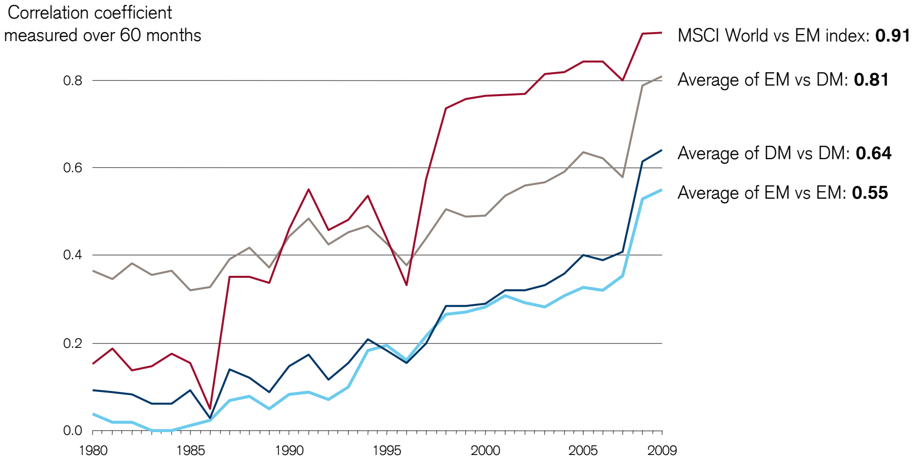
Source: MSCI Barra; S&P

Beta



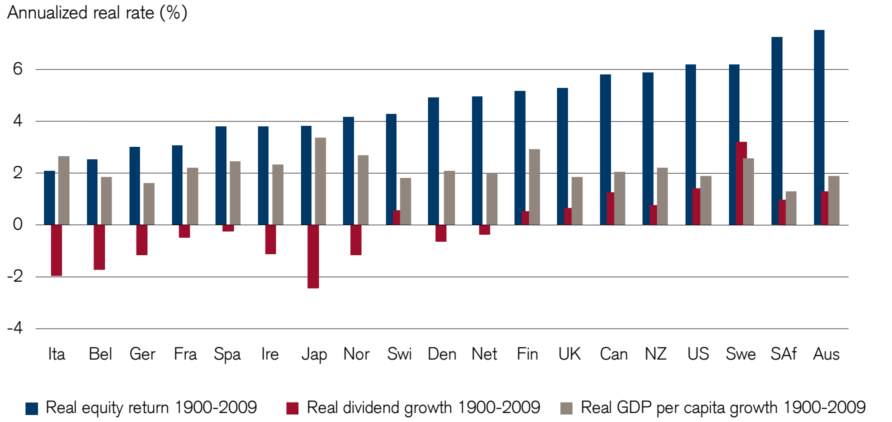
Higher beta (1.3) ➔ higher expected return (+1.5% p.a.) as reward for risk

Diversification



Source: Authors' analysis; data from MSCI Barra and S&P

Economic growth



Source: Authors' analysis; data from 1900 to 2009 inclusive

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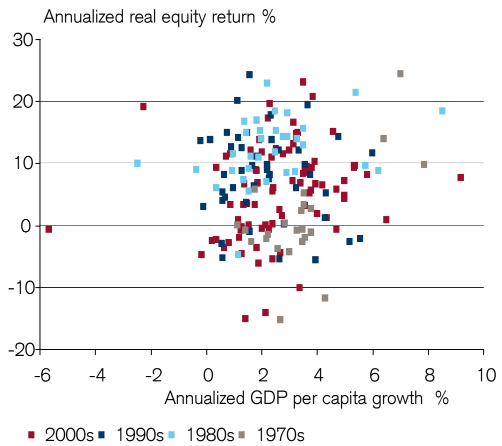
Shorter intervals



- Why no relationship?
- When an economy grows, investment risk declines
- When risk declines, returns should be superior
- But after risk has declined, returns should be lower
- So buying after economic growth should give rise to lower returns

Source: Authors' analysis; data from S&P, MSCI Barra, Morningstar, Global Financial Data, Mitchel, Maddison, IMF

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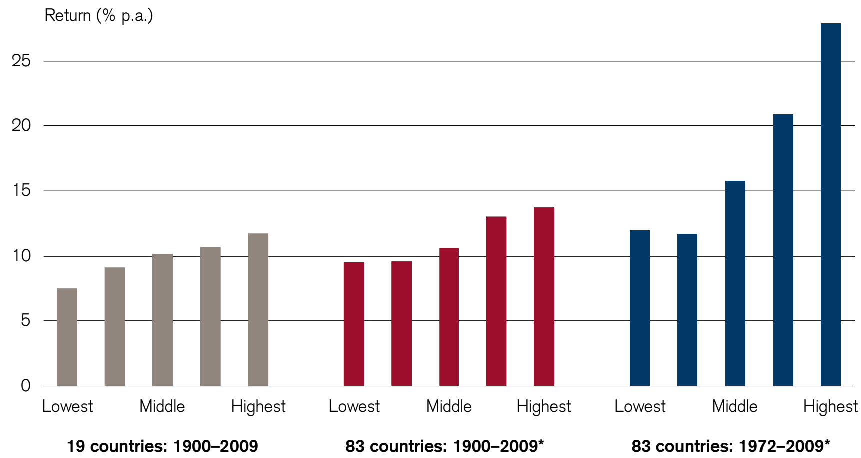
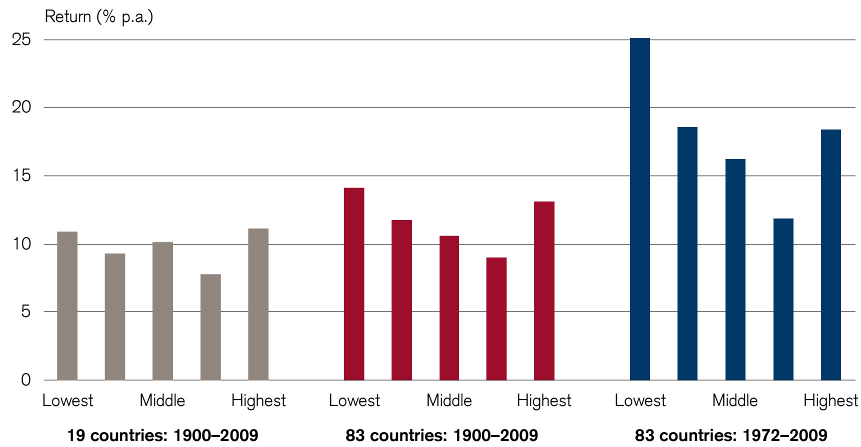
Buy based on perfect knowledge of <u>future</u> growth



Clairvoyance about future GDP growth would make us wealthy

Buy based on recent GDP growth



Countries with higher past growth have <u>not</u> generated larger returns

Emerging markets

- Despite setbacks, impressive performance over last decade
- Still appreciably riskier than developed markets
- Diversification benefits now lower, though still worth having
- Above-average beta ➔ higher reward for risk (+1½% p.a.)
- No evidence that fast-growing economies generate higher returns
- The case for over-weighting emerging markets has yet to be made