

DECENT EXPOSURE

■ Fund managers have different approaches to getting exposure to emerging markets. **Laura du Preez** found out what they look for.

THERE ARE TWO WAYS TO GET EXPOSURE to emerging markets when, as is currently the case, shares on these markets may be overvalued and economic growth alone will not ensure investment success. You can either ask a skilled asset manager to cherry-pick shares on your behalf or you can get exposure to emerging markets through global brands listed in developed countries that have broad exposure to emerging markets.

The developed market route

TO DERIVE THE BENEFITS OF BEING EXPOSED TO emerging markets, you don't have to venture into countries where the food may upset your stomach, the taxi drivers refuse to speak English and companies follow unfamiliar practices. Simon Pearse, the chief executive officer of Marriott, says rather than taking the risk of investing in unregulated markets where corporate governance may be lacking, you can access global brands listed in well-regulated markets that have a large exposure to emerging markets.

As examples, Pearse listed:

■ Vodafone, a leading mobile communications company, has a 34-percent exposure to emerging markets;

■ Unilever, a producer of food and other necessities, has a 37-percent exposure to emerging markets;

■ British American Tobacco has an unbroken 10-year track record of paying dividends and now sells 40 percent of the cigarettes it produces to China;

■ Sanofi Aventis, a pharmaceutical company, is registering 70 percent of its growth from emerging markets;

■ Pfizer, the world's largest pharmaceutical company, makes 47 percent of its sales in emerging markets;

■ Diageo, a consumer goods company with a number of famous alcoholic drinks brands, such as Guinness, Smirnoff, J&B, Johnnie Walker and Baileys, sells 25 percent of its goods in emerging markets; and

■ General Electric, which generates and distributes

electricity, and provides lighting, motor and aircraft engines, locomotives and appliances, sells 20 percent of its goods and services to emerging markets.

You will not find an emerging markets fund among Marriott's unit trust fund offering, but all the above shares are in Marriott's flexible asset allocation International Growth Fund. This fund, domiciled in Ireland, is a US dollar-denominated fund, but you can invest in it through a rand-denominated feeder fund.

A number of asset managers including Coronation, which has a dedicated emerging markets unit, have international funds that invest in global brands to benefit from economic growth in emerging markets.

Other fund managers combine developed world shares with those in emerging markets in a single fund or fund of funds.

Another asset manager that does not see the need for setting up a dedicated emerging market fund is Orbis, Allan Gray's offshore sister company.

Mahesh Cooper, a director of Allan Gray who is responsible for marketing Orbis in South Africa, says Orbis considers all shares across the globe and invests in them if they are attractive, rather than because they are in either developed or developing markets.

Cooper argues that selecting equities based on their individual attractiveness ensures that you increase diversification, which may not be the case for a fund or exchange traded fund that tracks an index. Orbis offers you access to international markets on this basis through its Global Equity Fund. The only regional equity funds Orbis runs that give you greater access to attractive regions are those focused on markets in Japan, Asia excluding Japan, and Africa.

When it comes to obtaining exposure to emerging markets through shares listed either in those markets or on exchanges in developed countries, Cooper says Orbis's choice of shares would again "depend on the attractiveness of individual shares relative to their intrinsic value". He says you should not buy expensive shares just because they are listed on >>

>> the exchange of an emerging market.

Investec advises against investing in a dedicated emerging market fund at this time, largely because investors are probably a year too late.

Investec Asset Management director Jeremy Gardiner says developed world stocks that access their growth from emerging markets are probably the way to go, because the stock markets of developed countries are not as overvalued as emerging markets.

Emerging market equities are now priced for a very rosy future, which is not necessarily what the future looks like, he says.

"If there were to be a shock of any form that reduced risk appetite, the emerging market funds would be hit hard too. In fact, emerging markets and commodities are currently seen as two potential areas that are overvalued and could develop into bubbles," Gardiner says. "We would rather recommend choosing a fund that invests in great companies whose earnings are generated from the developing world."

However, Gardiner says, one area of emerging market investing that many investors have generally overlooked is local emerging market debt, or bonds issued by emerging market institutions in their own currencies.

"Emerging market debt, in our view, will be the beneficiary of positive flows for many years to come as greater numbers of investors seek to benefit from the positive fundamental changes taking place in emerging markets. Key drivers for growth include the fact that emerging markets are typically rich in resources, undergoing positive reforms, have a young and large labour force, and are expected to deliver growth from a low base," he says.

Direct investing

IF YOU WANT TO INVEST DIRECTLY IN EMERGING markets, look for a fund manager that knows how to pick the right shares. Right now, an investment that closely follows an emerging market index may not be the best way to go.

Coronation has an emerging markets division focused on finding the right investments. Suhail Suleman, a portfolio manager in this division, says there is "an inherent inconsistency" in investing in the shares that make up an emerging market index.

For example, Suleman says an emerging market fund that invests only in companies listed in an emerging market index would not invest in a company such as Yum Brands (which includes Kentucky Fried Chicken and Pizza Hut), because it is US-listed and regarded as a developed world company, yet emerging markets together account for over half its profits. On the other extreme, most emerging market funds would have no problem investing in a company like Tata Consultancy Services because it is listed and domiciled in India and yet it derives 95 percent of its revenue from developed world clients.

"Most Korean companies that are domestic-

focused are also serving what is essentially a developed, wealthy market, but emerging market funds will generally invest in them because Korea is an MSCI Emerging Market index member."

Suleman says although a poor regulatory framework for companies can theoretically add to the risk of an investment, the actual risk in individual companies may be overstated.

For example, he says, even though regulation in China may not be to our standards, all Chinese companies in Coronation's funds are bought through a listing on a developed market, such as the New York or Hong Kong stock exchanges. These exchanges impose mandatory reporting, accounting and corporate governance standards with which the Chinese companies must comply in order to list there.

The quality of regulation, financial reporting and corporate governance is expected to improve over time. In the interim, the investment universe in emerging markets is sufficiently large to enable fund managers to avoid companies where there is reason to be concerned, Suleman says.

Focused funds

ALTHOUGH THERE IS A STRONG ARGUMENT FOR not following an emerging market index, most managers argue for investing in a fund that can invest in any of the countries listed in such an index.

Suleman says that, as a general principle, South Africans should consider an investment with access to all the established emerging markets as listed in the MSCI Emerging Markets index. But while the fund should have access to these markets, it shouldn't be invested in them in the same proportion as the index.

Before the peak in the emerging markets index in early 2008, for example, Coronation had a low exposure to Brazil, Russia, India and China (the Bric countries) compared with the index because share valuations in these countries tended to be expensive.

"When the market collapsed at the end of that year, we were able to find many fantastic businesses in the Bric countries at once-in-a-lifetime valuation levels, and we increased our exposure to these countries substantially," Suleman says.

Michael King, the director responsible for Franklin Templeton in Africa, says Franklin Templeton offers South Africans access to three offshore funds that invest across emerging markets. Among these, one focuses on innovations and one on smaller companies. It also has a South Korean fund, an Eastern European fund and a Thai fund.

Ashburton's one dedicated emerging market fund is its Chindia Fund. Adam Benzmira, Ashburton's business development executive, says Ashburton prefers to focus on China and India for a number of economic reasons, but the two important ones for South African investors are that these two economies are very complementary and, importantly, have a low correlation to the South Africa economy. □