FRANKLIN TEMPLETON

WHAT MAKES AN EMERGING MARKET?

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Emerging Markets used to be a bit easier to categorise. Twenty years ago this was a bit more black and white and they really were the final frontier. The exotic, the distant and the remote.

Twenty years is not a long time in history. Tony Blair was Prime Minister in the UK. Saving Private Ryan hit our cinemas. But it's a long time in terms of business. Google was founded 20 years ago. It was still early days for Amazon. The fax was still commonplace. And the Chinese economy was around a 1/13th of what it is today[1].

Fast forward to 2018 and the Chinese economy is the second largest in the world[1]. 61% of global mobile payments are made in China[2]. Korean company Samsung is the 14th largest company in the world[3]. The opportunities offered by today's emerging markets are modern stories of technology and the growing middle classes. Investors are looking for a sweet spot where the political and social growing pains have largely ended and the economic growth is at the beginning of its journey.

EDUCATION/I GUIDES

Main Topics

- Getting Started in
- What Makes an E
- How Risky Are Em
- Emerging Market

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1) INCOME PER INDIVIDUAL

The World Bank defines developing countries as those with either low or lower middle income per person of less than about $4,000.

Rapid growth is a common denominator of emerging and frontier markets. Although our vision of Argentina may involve tango halls and polo, between 2002 and 2017 Argentina's average income per person grew on average by 5.2% per year. In Britain and the US, annual growth rates were a more sedate 2.6% and 3% respectively over the same period. South Korea, the Czech Republic and Poland are further examples of emerging market per-capita income growth, with annualised growth rates of 4.2%, 4.6% and 5.9% respectively[4].

Any traveller to India will have noticed the burgeoning coffee shops with affluent middle-class urbanites sporting the latest logos, providing a stark contrast to the average standard of living seen around them. Average incomes remain low in many emerging markets but, as always, averages disguise the top echelons.

24% of BMW's global sales last year came from China[5], where they have a joint venture with a local firm which develops, manufactures and sells them. By comparison, just 14% came from the US and 12% from Germany[5]. The purchasing power of the middle class is strong. More Guinness is sold in Nigeria today than in Ireland[6]. Go figure!?

2) POTENTIAL FOR VOLATILITY

These markets can be volatile. They tend to be more vulnerable to natural disasters, external price shocks from more powerful nations and domestic policy instability. A recent example is the trade spat between China and the US which has sent ripples around the rest of the world. Mexico is another clear illustration of how specific smaller nations can be wounded by the actions of others. That said, everything is relative. Increasing economic strength in the emerging markets means volatility is generally lower than in the past – even the volatility of the UK market has exceeded the emerging markets over certain periods.

3) IMMATURE CAPITAL MARKETS

A further factor in being classified as 'emerging' is a nations capital markets being 'immature'. A market might not have a solid track record of foreign direct investments. Information may be harder to get. Some investments may be less easy to buy or sell. They may have capital controls. Corporate governance may be a little less ‘robust’. These are all risks but also make the markets less perfect. They add a bit of friction. Which adds potential return and competitor advantage for those on the ground, who do the leg-work to understand where companies are ‘sound’ and where it is better to walk-away.

4) GROWTH AND RISK

As some of the emerging markets flex their muscles and grow, they can offer impressive returns. Over the three years to the end of November 2018, one of the highest returning stock markets was Thailand which grew by 80.5% over the year[7]. A balanced global share portfolio feels incomplete without exposure to some emerging markets.

However investors should be under no illusions and expect a bumpy ride. These markets can suffer from changing fundamentals or simply a fall from grace in global investor sentiment. Back in 2008, the year of the global financial crisis, the emerging markets sector recorded a six-month slide of almost 45%. Only to rise by nearly 80 % in the following year[8].

As always it is extremely hard to pick winners in any market. Which emerging markets will rally forth and deliver strong growth, growing income per capita and improved capital controls, making the jump over into the developed markets club?

And which ones will languish by comparison?

If you don’t know the answer, buying a mixed basket of shares from a collection of countries is one way to spread your bets around. Have a look at the companies in our investment trust here and in which parts of the world we invest below.

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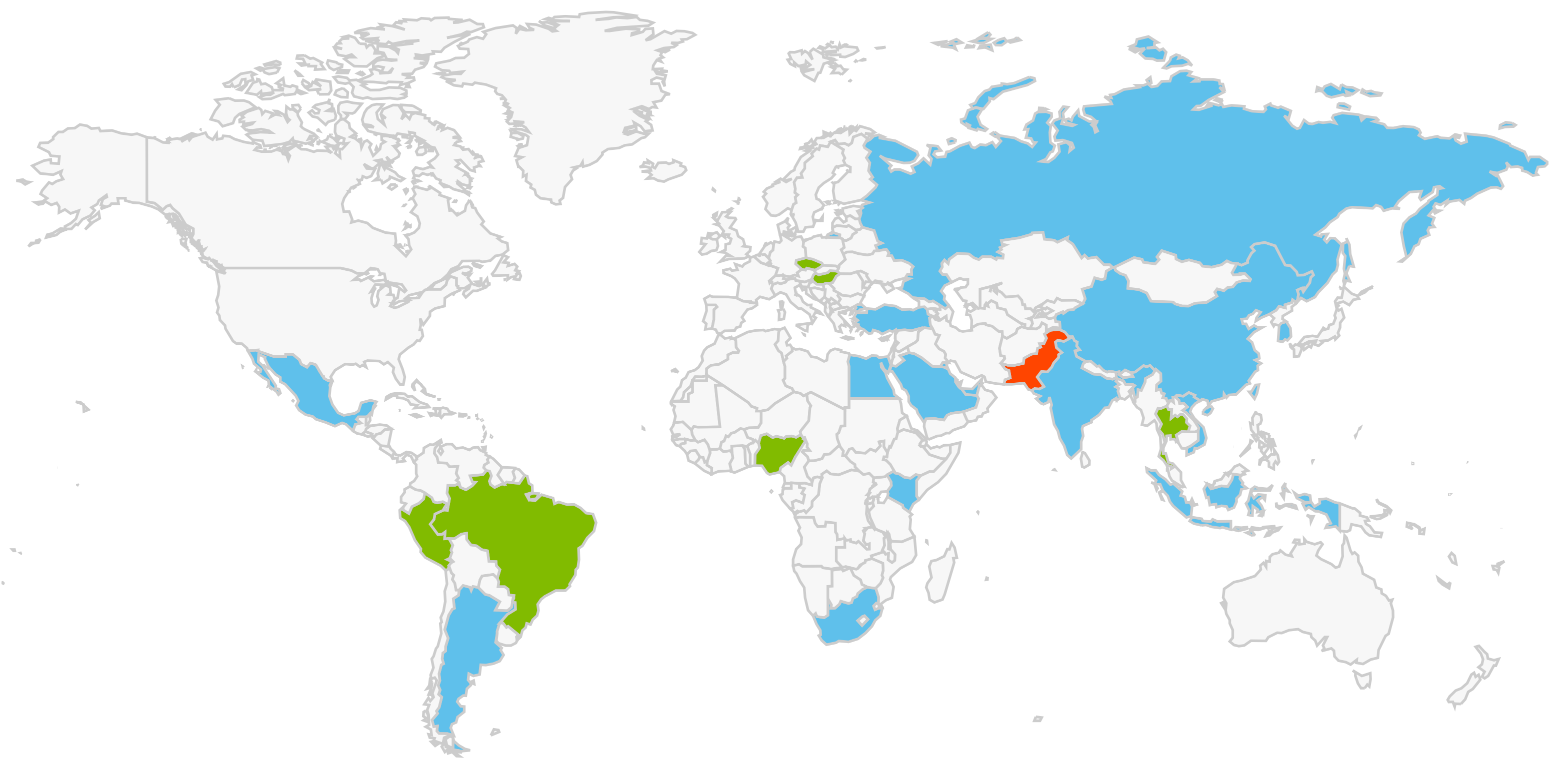
Regional Outlook

As at 30 September 2018



1. Source: IMF DataMapper, China Gross Domestic Product (GDP) in current US$, as at October 2018.

2. Source: Mobile Payments Conference / eMarketer as at 2 Jul 2018.

3. Source: PwC Global top 100 companies by market capitalisation 31 March 2018 update.

4. Source: UN data / The World Bank as at 1 Oct 2018.

5. Source: BMW Group press release "BMW Group sells more than 2 million vehicles in 2017 so far" 13 Nov 2017.

6. Source: pulse.ng.

7. Source: Trustnet as at 30 November 2018.

8. Source: Franklin Templeton as at 31 January 2019.

MORE INFORMATION

To learn more about accessing emerging markets explore the links below.

GETTING STARTED IN EMERGING MARKETS

WHAT MAKES A MARKET EMERGING?

HOW RISKY ARE EMERGING MARKETS?

HOW TO INVEST

BEGINNERS GUIDE TO INVESTMENT TRUSTS

IMPORTANT INFORMATION

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