MOST FAVORED NATIONS

For investors, not all emerging markets are created equal

By KRISTEN D'ANDREA

Stocks in many emerging markets have fallen recently, leading some investors to consider cashing in their holdings, even if it means taking a loss.

But other bargain-hunters view the fall in share prices as a buying opportunity. While not all emerging markets are created equal, a savvy investor can weather the bumps in the road and capitalize on the growth potential in these developing areas of the world.

At J.P. Morgan Private Bank, most clients are interested in investing for the long term, looking for moderate growth for their assets over a 10- to 15-year strategic framework, according to Melville-based investment specialist Nicholas Frangas. As such, J.P. Morgan Private Bank compartmentalizes the "good" versus "bad" investment options in every asset class.

When it comes to emerging markets, the bank advises its clients to avoid countries that are commodity-based, such as Brazil, which it believes will continue to face pressures.

"We are actively looking for entry points [in those economies], but we don't see them right now," Frangas said.

Economies the bank does favor include Mexico, where manufacturing has come online and helped to create a strong trade market for the United States. Additionally, wages are still quite low in Mexico relative to China, where labor costs have risen dramatically over the last decade, Frangas said.

Overall, "we prefer our clients to be more heavily invested in developed markets, such as the United States, Japan and parts of Europe," he said, noting 2014 will be a year of more modest returns across the board globally.

A generation ago, investing in emerging markets was a different story. Investors looking to capitalize on growth in less developed countries didn't need to look much farther than the BRICs (Brazil, Russia, India and China), which could be traded as one entity. Today, with instability in Russia and low growth in China, investors need to get more granular.

"The cycle is evolving and the investor's

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CRAIG FERRANTINO: Mexico, Indonesia, South Korea and Turkey are where China was a few years ago.

Photo by Bob Giglione

Investment opportunities and risks in the developing world

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thinking has to evolve as well," said Robert Genalo, a first vice president and wealth management adviser for Merrill Lynch Wealth Management in Melville.

Investors choosing to allocate money in emerging markets need to pay attention to long-term trends and keep any headline risks or background noise in perspective, Genalo said.

For instance, according to the National Intelligence Council's Global Trends 2030 report, by that year a majority of the world's population will be out of poverty for the first time in history. This trend toward a rising middle class, particularly in emerging markets, will bode well for economic growth, Genalo said.

Emerging markets are currently responsible for more than half of global gross domestic product growth and 40 percent of investment worldwide. By 2025, China could provide a third of the world's economic growth, according to the World Bank.

The report notes that Asian countries will surpass the United States and Europe combined in overall power indices, including the size of their economies, populations and militaries, as well as in the extent of their technological investment.

In contrast, the United States and many other developed nations face aging populations. By 2030, the median age in the wealthy countries that belong to the Organization for Economic Cooperation and Development is expected to jump to 43, up from 38 in 2010.

One would think China – where the government plans to move away from a rural economy – would be a good investment opportunity. Recently, however, "China has been a poster boy for low growth," Genalo said, noting the additional risk of potential scandal and corruption. "It's a study in contrast."

As developing countries increasingly demand items like iPads, cellphones, Disney movies and Internet access, there will be tremendous growth on the consumption side, according to Craig Ferrantino, president of Craig James Financial Services in Melville. Still, as consumption rises, it can put a strain on a country's resources, including food and water.

"These investment implications have to be identified," Genalo said.

While no investment is risk-free, the emerging markets face potential economic threats from currency, inflation, political, export and liquidity issues.

"Most are emerging economies and, as these countries go about their business, things come up that the United States takes for granted," Frangas said. China, for instance, uses an unregulated shadow banking system, which is not a part of the typical regulated banking sector.

"That is something that concerns us," he said.

Still, for the long-term-focused investor, countries such as China, where new leadership has promised both greater foreign exchange policy liberalization and a continuation of structural shift from export-driven to consumer-driven growth, offer a stronger currency that suits consumers, Frangas said, noting United States-China currency exchanges have been delivering steady returns since their inception.

EMERGING MARKETS ARE RESPONSIBLE FOR MORE THAN HALF OF GLOBAL GROSS DOMESTIC PRODUCT GROWTH

To be sure, currencies are a huge driver, as using U.S. dollars to buy stocks or mutual funds in markets where the currency fluctuates widely can create risk, Ferrantino said.

Other risks are related to the political environment in certain countries. When the government changes, such as occurred in Egypt, it can affect the country's economy, at least for the short term, Ferrantino noted.

Additionally, situations like the current unrest in the Ukraine, which is impacting the Russian stock market, need to be considered.

Ferrantino is watching countries such as Mexico, Indonesia, South Korea and Turkey, which have become what China was four or five years ago, he said. Additionally, the Philippines, Iran, Iraq and sub-Saharan African countries with oil or other commodities offer tremendous growth potential; while each country has different levels of productivity, Nigeria, for example, uses crude methods to mine its raw materials, allowing it to do so at lower cost, Ferrantino said.

And many emerging nations don't have a great deal of debt because of their lack of infrastructure and spending on their people, he added.

"Depending on a client's age and risk tolerance, emerging markets can be a strong aspect to long-term portfolio growth," Ferrantino said. "There is potential for tremendous growth … but it's not that easy."