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## **Not Your Grandfather's Emerging Markets Anymore - Especially China**

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It has been widely reported that 2010 is the year that China passed Japan to become the second largest “country” economy in the world. Less reported, however, is a more important fact; 2010 or thereabouts will go down in history as the year that China became a more important player in world economic **growth** than the United States. The US is expected to grow GDP by about 2% in 2011, while China’s GDP growth is projected at 9%. 2009 US GDP, according to the IMF, was \$14 trillion and China GDP was \$4.8 trillion. Therefore, China will add about \$200 billion more than the US to overall global GDP next year.

Back in the 1980s and early 1990s, Emerging Markets were characterized as Third World Countries. These countries lacked significant infrastructures to support local economic activity, let alone allow them to be players at the global level. They most often were ruled by dictators or oppressive regimes that had no desire to allow their people to think for themselves. Knowledge was power; as long as the dictators kept the people under their foot (and uneducated), they kept their power intact. This environment was not conducive for investment to outsiders. Investments were highly speculative and extremely risky due to this shaky geopolitical environment.

Over the past decade or so, we have seen an evolution in Emerging Markets. Changes in political structure, and the pursuit of the almighty dollar, have led to improved economic policies. In turn, these improved economic policies have led to more stable financial markets. On top of that, globalization and the associated huge demand, and subsequent higher prices, for commodities have benefited many Emerging Markets countries. They have been able to use the proceeds from commodities exporting, combined with their massive and incredibly competitive (cheap) labor forces, to strengthen their domestic finances. Capitalism, or whatever “they” want to label it, has become firmly rooted.

Many Financial Advisors today are still reluctant to dedicate the proper portions of an investor’s portfolio to Emerging Markets based upon old time beliefs. Emerging Market investing should now occupy a considerable portion of most investors’ equity portfolios.

Here are just some of the statistics associated with Emerging Markets:

1. The International Monetary Fund (IMF) is forecasting global GDP growth of 4.2% for 2011 and an average of 4.6% for 2012-2015. Developed countries are expected to grow at 2.2% and 2.5%, respectively, in those time periods. Conversely, Emerging Markets

as a whole are forecast to grow at 6.4% next year and 6.6% per year over the four following years.

2. Emerging Markets, at \$20.7 trillion, now account for 34% of global GDP according to the IMF. In 2011, they will add \$1.3 trillion to global GDP, while developed nations will only add \$900 billion. The majority of this growth will come from Asia and South America.
3. Emerging Markets also account for 85% of the population of the world.
4. On 10/31/10, the P/E ratio of the MSCI Emerging Markets Index was 14.8. While not cheap, it's not expensive either. The 12-month forward earnings growth rate was 14.8%.

Emerging Markets mutual funds have seen inflows of about \$2 billion per month this year, with no end in sight. Some expect the potential for bubbles to develop in some of these Emerging Markets as investors chase stocks.

Like so many markets these days, volatility will be present in Emerging Markets from time-to-time, and if history is any guide, to a potentially large extent. Investors need to be mindful of this and should contemplate enhancing their Emerging Markets buy and hold approach with a **tactical approach**. The tactical approach will periodically increase and decrease exposure to Emerging Markets in an attempt to reduce Emerging Market risk and volatility.

This is not your Grandfather's equity world anymore. But your Grandfather would certainly encourage you to have a risk management technique available for your exposure to the new Emerging Market equity world.

Thank you,



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