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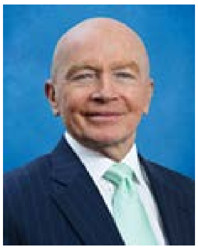
Emerging Markets: 30 Years of Growth

SUMMARY

- Emerging markets represent a very economically diverse group accounting for about 80% of the world's population.
- Emerging markets have developed over the years into a major asset class.
- We think it's important to be diversified not only across different companies, but across different industries and, most importantly, across different countries.



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The emerging markets genesis

The 30 years or so since the creation of a specific emerging markets investment category and the launch of the Templeton Emerging Markets Fund[1], the first listed emerging global markets fund, in 1987, has seen an interesting evolution of both emerging markets investing and global investing in general.

The term "emerging markets" was coined by International Finance Corporation (IFC) officials, in 1981, to give such markets a more uplifting and optimistic name. Previously, countries outside the group of developed markets had been referred to by different and sometimes unflattering names such as the "poor countries", "under-developed countries", "less developed nations", "the third world", "the South", and so forth. The emerging market universe was defined as all countries in the World Bank list of low and middle income nations. The definition fitted well with what most people considered to be emerging markets and included all countries in Latin America, Africa, Eastern Europe, and Asia (excluding Japan, Australia and New Zealand). Early investors saw the opportunities offered by those countries for good returns due to their generally rapid rates of economic growth. Initially, most of the countries were not open to investment because of various restrictions. Many were still in a socialist or communist government mode where the idea of a stock market or capital market for that matter, was anathema to the government leaders. The World Bank, International Finance Corporation and other multilateral institutions urged countries to adopt capital-market-based systems to encourage growth. This meant privatisation of government enterprises, which began to be operated on a more profit-oriented basis than before. Such companies became early candidates for stock market listings.

Emerging markets represent a very economically diverse group accounting for about 80% of the world's population. Their Gross Domestic Product (GDP) grew by more than 500% over the last 20 years, initially mainly through growth in investment and exports. Latterly, a growing middle-class population, with higher incomes and greater consumer demand in major emerging markets such as China and India, has also supported economic growth.

Investor's influence on emerging markets

Changes in investor's attitudes towards emerging markets investing have supported the growth and expansion of the stock markets in these countries. Initially, investors were apprehensive of investing in regions outside the typical developed international markets such as the US, UK, Germany and Japan. Emerging markets offered different challenges to those that were present in developed markets, including concerns such as a lack of proper regulation, paucity of information and transparency, political turmoil, social and economic instability, foreign investment restrictions and currency devaluation. While some of these risks still exist, they are not as prevalent as they were in the 1980s and 1990s, and, indeed, similar problems have begun to emerge in some developed markets. Moreover, investors have learned that most of these risks can be properly assessed and managed, providing more than commensurate returns.

Emerging markets – a major asset class

Emerging markets have developed over the years into a major asset class. The market capitalisation of emerging markets increased over 10 times from US$1.9 trillion as at end-1994 to US$21.1 trillion as at end-2014. The average daily turnover rose from US$7 billion to US$149 billion in the same period.

1. A US-registered fund, not available to UK investors

That's a growth of more than 20 times! Emerging market companies have raised more than US$3 trillion in Initial Price Offerings (IPO) and follow-on issues in the 20-year period ended 2014, clearly highlighting the significant investor confidence in these markets. Moreover, net portfolio fund flows into emerging markets have totalled more than US$200 billion in the same period. The growing interest in emerging markets over the last 20 years is also evident by the substantial increase in the weighting of emerging markets compared to world markets. The market capitalisation of emerging markets as a percentage of the global market capitalisation has risen from 13% as at end-1994 to 32% as at end-2014.

Frontier markets – a newer asset class

The evolution of international investing has continued in recent years with investors venturing into markets in regions such as Africa (excluding South Africa), the Middle East, the Balkans and the Baltics. The willingness of governments to open their markets and investors' desire for access to fast growing and developing markets has led to the development of this newer asset class – frontier markets. Typically smaller and less liquid than emerging markets, the frontier markets investment universe is sizable and has been generating significant investor interest. In our opinion, these markets have begun to look very interesting and could grow into tomorrow's full-fledged emerging markets. They are where many emerging markets were 15 or 20 years ago and so could provide investors with investment opportunities comparable to emerging markets in the late 1980s. We believe that investors should not miss the opportunity to take advantage of their growth.

The best way of investing in emerging markets

We believe the best way to invest for the long term in emerging markets is by investment in a portfolio with global emerging market exposure. This is crucial because it is possible to have all your eggs in the wrong basket at the wrong time. We think it's important to be diversified not only across different companies, but across different industries and, most importantly, across different countries. One reason why professionally managed strategies are so popular globally is because they enable investors to be well-diversified and have a variety of stocks that they probably couldn't properly research and invest in themselves. Unfortunately, many investors have portfolios that invest in only one country…their own. We see this as a big mistake because they are missing out on potential opportunities all over the globe, which is our job to uncover.

Important Legal Information

For more information about any Franklin Templeton Investments' fund, UK investors should contact: Franklin Templeton Investments, Telephone: 0800 305 306, Email: enquiries@franklintempleton.co.uk or write to us at the address below.

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