3 Reasons Why Investors Should Have Exposure to Emerging Markets

Description

With China's economy stuttering to a halt and Brazil now in a prolonged recession, emerging markets are not the hot investment they were earlier this decade. While emerging markets may have a volatile history and may expose investors to greater risks than developed markets, they do offer a range of opportunities that investors would be foolish to pass up.

Now what?

The advantages that emerging markets offer are numerous.

Firstly, they typically have far higher rates of economic growth than developed markets. Emerging economies are expected to grow by around two to three times faster than developed nations like Canada.

You only need to look at the performance of some of Latin America's fastest-growing economies to see this. Colombia's annual average GDP growth rate over the last decade is 4.8%, whereas Peru's is 6%, both of which are higher than Canada's annual average of 2% for the same period. Such strong growth rates imply a far higher rate of growth for companies operating in those countries, which should translate into rapidly growing earnings and higher stock prices.

Secondly, by investing in emerging markets, investors can geographically diversify their portfolio, making them less vulnerable to an economic downturn in any single market.

This could be seen during the global financial crisis, the worst economic slump the developed world has faced since the Great Depression. At the height of the crisis, when a number of developed economies were contracting, a range of emerging economies continued to grow.

In 2009, Colombia and Peru saw their economies grow by 1.7% and 1% at a time when Canada's contracted by almost 3%. As a result, both countries pulled through the crisis in relatively good shape and continued to grow strongly.

Finally, there is a growing trend towards growing consumption in emerging economies as wealth grows and the middle class flourishes.

This is a big plus for companies that are focused on providing goods and services that are in increasing demand. Both Colombia and Peru are heavily underbanked, yet with rapidly expanding middle class populations, there is a growing demand for banking, insurance, and investment products.

This has been a key driver behind the growth in earnings for **Bank of Nova Scotia's** (TSX:BNS)(NYSE:BNS) international business; it operates the fifth-largest bank in Colombia and third-largest in Peru. Over the last two years assets under management in the bank's international business have grown by almost 30%, while revenue is up by almost 7%.

So what?

Investing in emerging markets comes with a far higher degree of risk than investing in developed economies, and the lack of transparency surrounding company regulation and stock markets is of considerable concern.

However, Canadian investors can still gain exposure to some of the best positioned emerging markets without leaving the comfort of Canada, with Bank of Nova Scotia being one of the best options. This is because it has considerable exposure to a range of emerging economies in Latin America; its largest exposure is in the Pacific Alliance trade bloc, which is composed of Mexico, Chile, Colombia, and Peru.

Investors could also consider one of the many ETFs now available. The **iShares MSCI Emerging Markets Index ETF** (TSX:XEM) provides broad-based exposure to a range of emerging markets. This ETF is focused on tracking the performance of the MSCI Emerging Markets Index, which is a market-capitalization-weighted index designed to measure the equity market performance of emerging markets.

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1. Editor's Choice

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