Why Every Canadian Investor Should Have Emerging Markets Exposure

Description

Emerging markets performed poorly during 2018, as a confluence of events weighed heavily on their outlook and almost triggered a financial crisis in some of the most vulnerable developing economies. While uncertainty continues to weigh heavily on their outlook, many emerging markets are attractively valued. That is evident from the **MSCI Emerging Markets Index**, which consists of 24 developing countries, representing 10% of world market capitalization, having lost almost 20% over the last year.

Despite growing concerns over the outlook for the global economy, especially with China coming off the boil, it is time for investors to consider bolstering their exposure to emerging markets. Let's examine three key advantages that they offer.

Firstly, investing in emerging markets allows investors to reduce investment risk by diversifying their portfolios by industry and jurisdiction. This is particularly important for Canadian investors, because the **S&P/TSX Composite Index** is heavily weighted to financials and energy, which make up 33% and 18% of the index, respectively. By diversifying across different jurisdictions, investors can reduce the impact that an economic downturn in a single country can have on their portfolio.

Furthermore, because developing economies are far less correlated to major developed economies like the U.S., they tend to suffer less fallout during economic downturns and market corrections. This is evident from the global financial crisis, which peaked in 2009 and saw Canada's economy contract by almost 3%, yet the emerging economies of Colombia and Peru expanded by 1.7% and 1%, respectively.

Secondly, emerging markets possess the potential to generate outsized returns. Typically, developing countries grow at a far greater rate and have a longer growth runway than developed nations.

Canada's 2019 gross domestic product (GDP) is forecast to expand by 2% in 2019, which is significantly less than many emerging markets. Meanwhile, Chile's 2019 GDP is expected to expand by up to 4.25%, boding well for the performance of many companies operating in the Andean nation.

This augurs well for credit growth in Chile and will act as a powerful growth driver for **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), which has established a strong presence in the Andean nation. After a series of acquisitions over the last decade, Latin America is now a key growth driver for Scotiabank's international banking business, which is responsible for earning almost 36% of the bank's net income. That exposure also enhances Scotiabank's outlook by reducing its dependence on a slowing domestic housing market.

India is classified by the International Monetary Fund (IMF) as the fastest-growing major economy globally; it is expected to see its GDP expand by a whopping 7%, or more than three times Canada's 2019 forecast. This solid growth makes **Fairfax India Holdings** (TSX:FIH.U) a compelling investment. The company holds a diversified portfolio of investments across a range of industries, including financial services, agriculture, chemicals, airports, and logistics, giving it broad exposure to India's rapidly expanding economy.

One notable investment is the **National Stock Exchange of India**, where Fairfax India acquired a 1% equity interest for an investment of almost US$27 million in late 2016. By the end of the third quarter 2018, that investment was valued at US$58 million — more than double the initial investment.

As emerging nations develop, their stock markets grow at a rapid clip, mirroring the substantial increases in capital, wealth, business activity and GDP. By the end of the third quarter, Fairfax India's total portfolio of Indian investment had increased in value by slightly greater than 9% year over year to be worth US$2.3 billion. There is every sign that this brisk rate of growth will continue.

Finally, population, wealth, and consumption in emerging markets typically grows at such a rapid rate that demand tends to outstrip the supply of related services. This provides a ready-made opportunity for companies providing those goods and services to rapidly expand.

Scotiabank's growing presence in Latin America, particularly in Colombia, which remains heavily underbanked, is an excellent example. By the end of the fourth quarter 2018, the average balance of residential mortgages in its international business had grown by 35% year over year to $39 billion, while high-margin credit cards soared by 34% to over $9 billion.

What does it mean for investors?

While investing in emerging markets is far riskier than developed markets, the reward often outweighs the risk. By investing in Scotiabank and Fairfax India, investors can not only enhance returns but also reduce risk by further diversifying their portfolios across jurisdictions and industries. Because both companies are incorporated in Canada and listed on the TSX, they are required to comply with Canadian law, thereby reducing much of the regulatory, legal, and jurisdictional risk associated with investing in developing nations.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BNS (The Bank of Nova Scotia)
2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:FIH.U (FAIRFAX INDIA HOLDINGS CORPORATION USD)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Date
2025/06/30
Date Created
2019/01/26
Author
mattdsmith