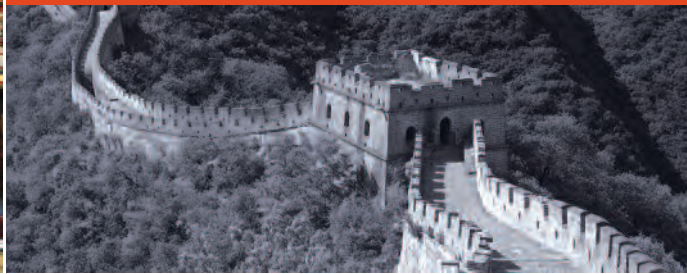


Find out how you could benefit from the world's most dynamic economies



Investors' Guide to Emerging Markets



**HARGREAVES
LANSDOWN**

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- 2 Introduction
- 4 Why invest in emerging markets?
- 5 What are the risks?
- 7 Who should invest in emerging markets?
- 8 Building BRICs - the four main emerging markets
- 11 How much in emerging markets?
- 12 How to invest in emerging markets
- 13 Areas of focus and investment ideas

IMPORTANT INVESTMENT NOTES Unlike cash, stock market based investments are not guaranteed and fall in value as well as rise; we therefore believe you should only invest for the long term (5+ years). Ultimately you could get back less than you invest. Tax rules referred to are those that currently apply, they can change over time and any benefit to you will depend on your circumstances. This guide is published solely to help clients make their own investment decisions; it is not personal advice. If you are unsure about the suitability of an investment for your circumstances, please seek expert advice. Source for all performance figures: Lipper Hindsight, bid to bid, net income reinvested. All information is believed to be correct as of 05/06/13.



Introduction

Mark Dampier

Head of Research at Hargreaves Lansdown

Like many parents, when my son was born I wanted to set aside some money each month for his future. Clearly I wanted the best return possible, and given the investment timescale of 20 to 30 years, I was prepared to take a high risk approach, focusing on the areas with the most potential. At the time it was clear to me to invest in emerging markets.

Back then emerging markets were peripheral to the global economy, but despite the volatility I was convinced they offered the best opportunities. Their economies were growing quickly, they had young, industrious workforces, and an array of natural resources. My modest investment each month turned out to be a most profitable one. Over more than two decades the fund I chose has delivered handsome gains, though of course nobody can foresee what the next 20 years will hold.

The phrase 'emerging markets' was first coined in 1981, but after nearly three decades of rapid growth the balance of power has changed. Forecasts show that emerging markets (notably Brazil, Russia, India and China - the 'BRIC' markets) will be responsible for 70% of global economic growth over the next few years. Indeed perhaps it is no longer appropriate to call them emerging markets at all. Goldman Sachs has started to refer to the largest eight emerging markets as 'growth markets'. These are the BRIC economies, plus Mexico, South Korea, Turkey and Indonesia. All have a share of global GDP greater than 1%. This is just the beginning of a process resembling the West's development during the 20th Century, although these markets remain higher risk. It is important to

remember that any investment can fall as well as rise, and you could get back less than you invest.

Emerging markets are the workshops of the world, supplying cheap goods, services and raw materials to the developed world. As exports boom and wealth grows, inhabitants of rural areas move to the cities in search of a better standard of living. Infrastructure improvements create a virtuous circle of growth and prosperity. In many cases emerging market governments are largely free of the debt problems troubling much of the developed world. I believe these markets hold the key to the next phase of global growth and should provide huge opportunities for all kinds of businesses.

Traditionally, emerging markets have not satisfied those who need income from their investments. Rather than pay dividends, emerging market companies often reinvested cash in projects they believed would produce better returns for shareholders. While it meant the prospects for capital growth were excellent, income was hard to find. However, times have changed and a dividend 'culture' has taken hold across many parts of the developing world. Today a larger proportion of emerging market companies pay dividends than those in developed markets, with Latin America and Asia particularly bountiful hunting grounds.

The global economy has changed beyond recognition in the last 30 years, and in the next 30 it will change even more. In my view emerging markets will remain a dominant investment theme. Whether you are looking to invest a lump sum, or save regularly into an ISA or pension, I believe emerging markets could provide excellent returns for adventurous long-term investors. I have already been investing in them for more than 20 years, and I fully intend to continue.



Why invest in emerging markets?

The balance of economic power is shifting from West to East, representing the continuance of a cycle where, over the long term, the world's economic centre of gravity shifts between nations and continents.

Asia accounted for the majority of world output in 18 of the last 20 centuries. It was only relatively recently – since the Industrial Revolution – that Britain, Europe and the US 'emerged' as economically dominant superpowers. Now, with development that bears a striking resemblance to our own Industrial Revolution (albeit over a much shorter period), the balance of power is returning to the East and other emerging markets across the globe.

China has established itself as a high growth, high investment behemoth. For 30 years it has produced what the West wanted, cheaply. It's a similar story in Brazil and India, renowned for mining and agricultural exports, and business and software services respectively.

The development of export-led manufacturing industries across the poorer countries of Asia has set a virtuous circle in motion. Demand for low and medium skilled labour has drawn people to the cities in their millions, attracted by the financial incentives found there. China is experiencing the largest urban migration ever seen, as every year around 18 million people (the equivalent of the population of Australia) moves from the country. In just two decades, 350 million people will have moved to China's cities, taking the urban population to over 1 billion.

The benefits of urbanisation critically depend on having the infrastructure in place to house, educate and transport the urban population. Infrastructure development therefore becomes both a cause and effect of economic expansion. More roads, railways, ports and airports create jobs and more capacity to produce. The scale is almost beyond comprehension. For example, China was due to construct over 6,000km of new rail track last year. To put this in context the UK's entire rail network is just 16,000km.



Emerging markets have been able to maintain this pace of development partly because of their young, dynamic and, above all, growing populations. Emerging markets are predicted to account for 98% of global population growth over the next 40 years, resulting in a plentiful supply of labour to fuel growth.

These growing populations are becoming more prosperous and better educated, resulting in a vast middle class, set to reach half a billion in India alone by 2025. This 'demographic dividend' means local consumers sustain their economies and they become less reliant on exports.

A trump card for many emerging countries is the abundance of the planet's most valuable resources found within their territories, from energy reserves such as oil and gas to precious metals such as gold and platinum. Along with continuing demand from the West the ambitious plans of emerging markets are driving a voracious appetite for natural resources, keeping demand buoyant. This creates opportunities for emerging markets to trade with each other, with Brazil, for example, helping to satisfy China's hunger for agricultural and other basic commodities.

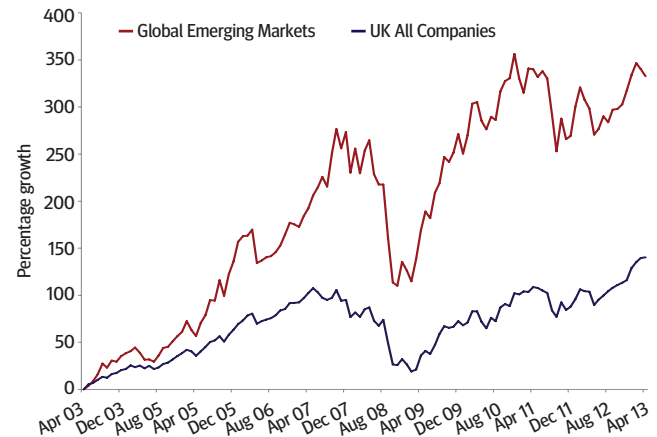
Last, but not least, lower government and consumer debt, none of the crippling pension deficits of the West and a banking system in better financial shape mean these economies are in a good position to continue growing strongly. Without doubt their development will be interrupted by a range of short-term threats, but the long-term drivers look promising.

What are the risks?

Investing in emerging markets carries the general risks of investing in shares, as well as specific political and economic risks.

In any fast growing economy there will be hiccups along the way and emerging markets are notoriously sensitive to global investor sentiment. This is one reason why their stock markets

Performance of Global Emerging Markets sector vs. UK All Companies sector



Past performance is not a guide to future returns.

tend to be more volatile than developed markets. The chart on the previous page compares returns from the UK and emerging markets. As you can see, emerging markets (red) have delivered superior growth to the UK market (blue) over the longer term, but with greater volatility.

Investing in any overseas market also carries the risk of currency movements. Over the last couple of years sterling has weakened against many other major currencies, which has enhanced returns from overseas investments. However, the reverse is also true and if there is weakness in an emerging market currency returns could be adversely affected. This occurred in 2008 when a falling oil price and investor aversion to risk caused a dramatic fall in the Russian stock market. A devaluation of the rouble added to losses for investors outside Russia.

In terms of economic and political development the largest emerging markets have come a long way and are now seen as much more stable. However, governments that appear stable can still topple, and in more extreme cases political instability can undermine economic growth. Elections, other political events and changing social attitudes can also disrupt the best-laid plans of companies and investors. For instance, China's communist style of capitalism has been admired by some but is viewed with suspicion by others. Much of the economy (for example banking) is under government control, which can lead to changes beyond companies' control, adding uncertainty and risk for investors .

Increasing transparency for investors is part of the process that emerging markets must go through, but only once a legal and regulatory framework is in place and is enforced investors can have real confidence. Corruption and political interference are still serious issues in some areas. Additionally, investors should be aware that there is always the risk that unexpected events will occur.

This is why shares in companies in some emerging markets trade at a discount to their equivalents in more developed nations. Despite the growth potential, the risks are greater, so investors are not willing to pay as much for their shares. However, as they mature into more open economies this can reverse to the extent that investors rush in, driving up prices. This can lead to a bubble as investors become overexuberant.

FACT

Emerging markets are home to 30% of the world's billionaires.

Who should invest in emerging markets

and where do they sit in a portfolio?

Emerging markets are now more mainstream than ever before, and given their growth prospects, we believe they are worthy of consideration in almost all equity portfolios. However, they are still high risk markets in which to invest. It used to be suggested that an average investor allocate no more than 5-10% of their portfolio to emerging markets, but a larger weighting could be chosen by some investors, depending on:

- The amount of risk with which they feel comfortable.
- Timeframe – emerging markets become increasingly fitting the longer the investment will be held for.

Emerging markets sit at the spicier end of an equity portfolio, but as they account for a large proportion of global growth they are becoming increasingly important for all investors to consider. Those who can take a longer time horizon (for example younger investors contributing to a pension) could consider making contributions on a regular basis. Saving monthly can help smooth out the inevitable fluctuations in the market and you won't need to worry every time the markets go

down. In fact, this can often work in your favour and allow you to buy more units cheaply.



Building BRICs - the four main emerging markets



Brazil

In the past it has been said Brazil is the country of the future and always will be. Brazil seemed to have so much potential that was never quite realised. However, the Brazilian economy has developed significantly in recent years, and is now starting to deliver.

For a long time Brazil suffered from economic and political mismanagement, which culminated in the government defaulting on its debts and devastating hyperinflation in the 1980s.

Over the past decade Brazil has gone through a substantial stabilisation with inflation, unemployment and interest rates falling dramatically. As a result Brazil has seen huge inflows of foreign investment and has embarked on an ambitious infrastructure development plan, investing \$550 billion, to support future economic growth and prepare for the 2014 football World Cup and 2016 Olympic Games.

Brazil is endowed with a huge variety of commodities and natural resources, including the world's largest fresh water supplies and a plentiful supply of fertile land, allowing up to 3 harvests a year. This has helped the country become an incredibly efficient agricultural exporter, capitalising on demand from the West, and also other emerging economies as they become more prosperous. Meanwhile other emerging markets are also pursuing their own ambitious expansion plans, creating opportunities for Brazil's well-developed mining and production sectors. With huge mineral and hydrocarbon wealth Brazil can supply the raw materials needed by other countries and crucially doesn't have the expense of importing these commodities for its own development.

With exports as diverse as iron ore and orange juice, Brazil is a major player in world trade. This is creating prosperity at home; rising disposable incomes coupled with a young and growing population should fuel domestic growth for many years to come.

Despite being smaller and perhaps less prominent than the likes of China and India, we believe Brazil's potential shouldn't be underestimated.



Many people equate Russia with oil and natural gas, two commodities the world cannot live without. Russia is still a major player in these markets (it is the world's largest crude oil exporter and has the world's largest natural gas reserves), but in the 21st century it has far more diverse foundations on which to build future growth.

Russia has been described as the world's treasure chest for its wealth of natural resources, including 15% of global gold reserves. Russia also has vast mineral wealth, including iron ore, nickel and chromium, all of which have wide industrial use. Its resource base in this respect is second only to South Africa. This puts Russia in an advantageous position to trade with other developing nations, notably China.

However, Russia is more than just a resources story. Wages are rising and living standards improving. Coupled with a low basic rate of income tax, domestic demand for everything from mobile phones to luxury food is booming. Although Russia was hit hard by the global financial crisis as exports slowed and the oil price fell, the growing role of the domestic consumer is now reducing reliance on commodities.

Unlike many Western nations Russia is now in good financial health with little government and household debt. Undoubtedly it still has political risks, and its stock market still needs to mature, however Russia is in a unique position of strength and the foundations are in place, so it could well become one of the top five global economies over the next 15 years.



The Indian market has been resilient in the wake of the global financial crisis, and economic growth has continued albeit at a slowing pace. This growth could be sustainable, as the economy is increasingly driven by domestic demand rather than exports.

India's biggest asset is its young population. Around a quarter of the world's under-25s live there and as more young people move to the cities, and their aspirations grow, lifestyles are changing. There is a large and growing middle class of several hundred million citizens with rising income. More people are using credit cards, buying mobile phones, eating out and spending on healthcare, travel and luxuries. Furthermore, many people in the rural areas of India are purchasing mobile telephones and other household goods and appliances for the first time.

India also has a large number of English-speakers (the world's business language) and a large number of highly-skilled graduates and engineers. Not only has this benefited Indian companies operating on the world stage, but it has made India a natural home for Western companies outsourcing some of their business processes and services overseas.

Undoubtedly India's infrastructure needs upgrading and expanding. However, the government has started tackling this, earmarking \$1.7 trillion for infrastructure development over the next ten years.

The Indian market is vulnerable to large swings in sentiment and volatility, and India also faces the problem of inflation if the

economy overheats, but with demographic trends on its side it offers significant growth opportunities.

China

China's economy has grown tenfold in three decades. As well as being the world's most populous country, it is the biggest exporter, and the single largest car market. Despite the economic turmoil in the West, it is still growing strongly and has overtaken Japan to become the world's second biggest economy. Forecasts suggest it could overtake the US by 2027 to become the largest.

Until recently growth has been largely fuelled by exports, but now China is in the process of transforming itself into a modern, self-sustaining economy, driven by a growing middle class. Chinese authorities are likely to contribute to this by improving healthcare and social safety nets, giving people the confidence to spend. Economic growth remains formidable at around 8% a year and the Chinese seem to be managing their economy well, although the threat posed by inflation remains a worry for investors.

The local economy in China looks healthy and is increasingly the main driver of growth. With wages increasing, disposable income is rising, so the Chinese are beginning to spend more on luxury goods, embracing consumerism and technology. All kinds of domestic industries are developing in response. The transition from mass-exporting to domestic-led growth will be neither quick nor smooth, but could be an important investment trend of the 21st century.

It is the sheer scale of the economy that makes China so interesting. For instance, Agricultural Bank of China has 320 million customers, more than the entire population of the US. Yet there are significant risks. Political interference is always possible, with many firms and industries under state control, and the interests of the government and shareholders are not necessarily aligned. There can also be significant volatility, particularly in relation to the domestic stock exchange where large swings of optimism and pessimism are prevalent. However, we believe some exposure to China is an essential component of an equity portfolio.

Other emerging markets

So far we have mentioned the four largest emerging markets, but there is also a wealth of opportunities in less well-known markets. South America is dominated by Brazil, but other nations offer exciting opportunities too. Mexico is somewhat reliant on trade with the US, so it had a difficult period during the credit crisis. However, it has come back strongly with rapidly developing industrial and service sectors. Meanwhile, Peru and Chile are benefiting from increased demand for their abundant natural resources.

In Asia, Taiwan is a hotspot for the technology sector and is forging closer economic links with China. With similar leading-edge technology, South Korea is also usually considered an emerging market in the investment world even though it is a more mature, developed nation. Indonesia, Thailand, the Philippines and Malaysia are also important markets in the region.

Russia tends to dominate Eastern European trade, but the economies of Poland, Turkey and the Czech Republic also offer opportunities. Turkey has a fast-growing financial system and is an important trade link between East and West. The dynamic Polish economy has low private debt and a healthy domestic market, and was the only country in the EU to avoid recession.

Finally, South Africa is rich in natural resources, notably gold and platinum, and is benefiting from continued global demand for commodities.

Why no Africa?

The emerging markets covered in this guide all have the preconditions for a successful stock market. These are:

Local investors – they can make sure that accounting is accurate and corporations responsible.

A degree of political stability – to encourage businesses and entrepreneurs to flourish.

An educated workforce – vital to drive development.

Favourable demographics – a young, dynamic population, no pension problems and a burgeoning middle class.

With the exception of South Africa, other African nations do not yet meet these conditions. Such markets are known as ‘frontier’ rather than ‘emerging’ markets, and whilst they exhibit exciting growth potential, they are extremely risky, and corporate governance might not reach the standards necessary to attract mainstream investors for many years to come.

How much in emerging markets?

Traditionally it was suggested that investors allocate no more than 5-10% of their portfolios to emerging markets, because of their higher risk profile.

However, as emerging markets have developed, they have become more mainstream, and given their growth prospects some investors might wish to have a higher weighting, provided they are comfortable with the risks.

Those investors who are particularly adventurous, or have a particularly long investment timescale (e.g. younger investors saving for retirement) can typically consider more exposure to emerging markets.



In summary, how much of your portfolio to allocate to emerging markets is a very personal choice, and depends on your attitude to risk. These markets are becoming increasingly important as economic power shifts over the decades, and as such it might be worth reassessing your approach.

How to invest in emerging markets

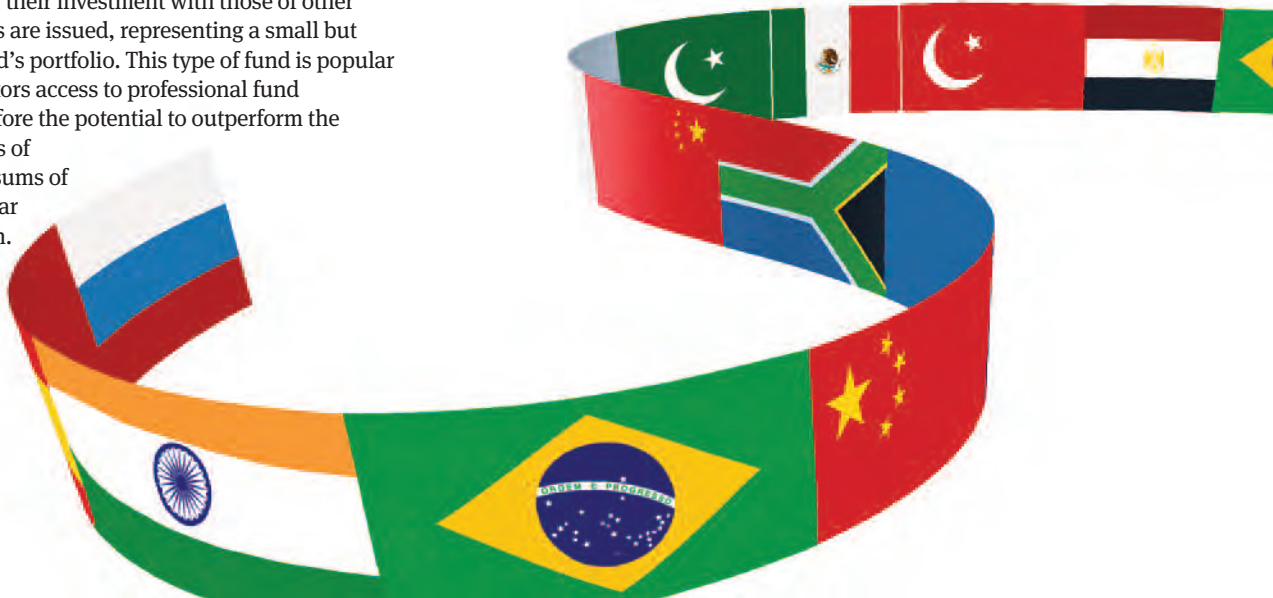
Once you have made the decision to invest in emerging markets, there are a number of ways of doing so.

The most popular way of gaining access to these markets is through a fund which invests in a portfolio of shares.

There are a number of different types of fund available, but we believe that for most investors unit trusts and OEICs (open-ended investment companies) represent the best choice. These funds allow individuals to invest in a large portfolio of shares (often 50-100 companies), pooling their investment with those of other investors. Units or shares are issued, representing a small but equal fraction of the fund's portfolio. This type of fund is popular because they offer investors access to professional fund management (and therefore the potential to outperform the market), and the benefits of diversification on lump sums of as little as £500, or regular savings of £50 per month.

Exchange Traded Funds (ETFs) track the performance of a particular stock market index, rather than being actively managed. We consider that actively

managed funds can have significant advantages over those which simply track stock market indices, as good fund managers have the potential to add considerable value through stock selection, especially in emerging markets.



Areas of focus and investment ideas

There is a large selection of unit trusts and OEICs investing in emerging markets with different degrees of specialisation.

For further information on an individual fund and its risks, please see its Key Features or Key Investor Information Document. These are available from www.hl.co.uk

For investors looking to dip a toe in the waters of emerging markets for the first time, or those looking for a core holding for the emerging markets portion of their portfolio, we would suggest a broad-based emerging markets fund, where an expert manager can select the best opportunities from across the full spectrum of emerging markets.

In recent years, the developing world has established a culture of distributing profits to shareholders and there are now many income funds in these regions. Globally, emerging markets now account for 23% of stocks paying a yield greater than 3%, compared with less than 10% in 1995. Furthermore, since 2000, emerging and Asian markets have seen their dividends grow faster than any other global market.

For those wanting more specialised exposure, but still diversified across a number of countries there are regional funds that can be considered. For those looking for

exposure to one country in particular, or to flavour their portfolio with their specific preferences, there are also many single country funds available.

Here we list details of some of our favourite emerging markets funds.



Aberdeen Latin American Equity

Managed by a highly experienced team with a conservative approach to investment which looks to find the best quality companies and hold them for the long term. As well as a large weighting in Brazil the team have positions in Mexico, Colombia and Chile.



Aberdeen Asia Pacific

A broad-based fund focusing on the Far East which includes some exposure to the region's more developed economies, such as Singapore and Hong Kong. Hugh Young and his team have shown time and again that they can generate superior returns, even in an uncertain environment. Given the calibre of the team and its relatively conservative approach, we believe this fund represents an excellent choice for long-term investors in Asia.



JPM Emerging Markets

Managed by Austin Forey and his experienced team who look to invest in solid, reliable businesses and hold them for the long term. The largest weighting is currently India, but the team also hold key positions in Brazil, South Africa, Hong Kong/China and South Korea.



Jupiter India

The Indian economy has undergone a significant transformation over the years, reducing its reliance on agriculture and becoming increasingly service-based. Increasing urbanisation and growing consumer wealth have been fuelling economic growth. For investors wanting pure exposure to opportunities in India, we believe this fund, managed by the experienced Avinash Vazirani, represents an excellent choice.



Neptune Russia & Greater Russia

Russia is about more than just its natural resource wealth. Whilst this fund has key holdings in energy and commodity stocks, manager Robin Geffen is also spotting plenty of opportunities in consumer-facing businesses. He has demonstrated a knack for profiting from Russia's volatile market time and time again.



Newton Asian Income

Asia is full of companies with predictable profits, low debt and dominant market positions and manager Jason Pidcock has many years of experience of investing in the region. He has shown that a patient income investing strategy works well and has strongly grown the income paid to investors over time, although there are no guarantees this will continue. We believe this fund is an excellent long term choice for those looking to diversify an income portfolio and gain exposure to some of Asia's fastest growing economies.



Newton Emerging Income

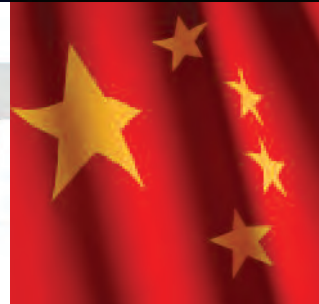
This fund offers a combination of exposure to fast-growing emerging markets, with the attraction of regular dividends. The managers, Sophia Whitbread and Jason Pidcock, focus on defensive, domestic businesses with the industrials sector favoured. We believe this fund offers an excellent long-term choice for investors looking to diversify their sources of income, while gaining exposure to some of the world's fastest growing markets.



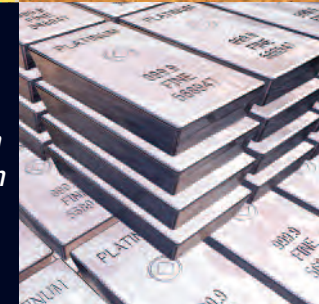
FACT
In 2006 Petrobras, the Brazilian oil giant, made the biggest oil discovery since 1976 - more than 5 billion barrels.



FACT
India's middle class is set to reach half a billion people by 2025.



FACT
China will have an estimated 221 cities with a population greater than 1 million by 2025. Today Europe has just 35.



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If you have any queries

📞 Call: **0117 900 9000**

🌐 Visit: **www.hl.co.uk**

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