

SPREADING THE RISK

HOW MUCH? When it comes to investing in emerging markets, perhaps no other question is as crucial. To answer it, first consider when you will need the money and how much risk your stomach can handle. And then don't put everything you have in one place.

Sound familiar? "It's a risk-reward situation, just like anything else," says Alexandra Armstrong, a Washington, D.C., financial planner.

In general, investors with a long-term view can afford to allot more to emerging markets than can investors who will need the money sooner, investment advisers say. They also agree that such volatile markets should be only a fraction of an investor's portfolio.

But that's pretty much where consensus ends. In particular, advisers disagree on precisely how much an investor should put into emerging markets.

"Emerging-markets exposure ought to be 10% to 15% of an investor's international exposure," says George Murnaghan, a vice president at Rowe Price-Fleming International in Baltimore, the joint venture of T. Rowe Price Associates Inc. and Fleming Group, which manages T. Rowe Price's international funds. That puts Mr. Murnaghan's recommendation at the low end. If an investor, for instance, puts 25% of his or her money into international stocks, that would leave only 2.5% to under 4% of the entire portfolio in emerging markets.

More, More, More

Others suggest putting in more. William John Mikus, a managing director of Financial Design, an investment advisory firm in Larkspur, Calif., would put one-third of an investor's international stocks in emerging markets; that could translate into about 8% of an entire portfolio.

Nicholas Bratt, director of global equities at Scudder Stevens & Clark Inc. in New York, goes for an even more-aggressive allocation. Mr. Bratt would put 25% of an investor's entire portfolio in emerging markets, especially if the money is intended for retirement in 25 years.

But others are wary of such high percentages. "Everyone loves [diversified assets] when they're going up," says Jeremy Duffield, a senior vice president at Vanguard Group, Valley Forge, Pa., which has not come out with an emerging-markets fund, in part because of concerns about high expenses and low liquidity. "Skepticism is warranted," he says.

Campbell Harvey, an associate professor of finance at Duke University's Fuqua School of Finance in Durham, N.C., says that it's just as well that investors put little into emerging markets. Although he advises putting 6% to 20% of an investor's portfolio into emerging markets, he doesn't think the market could sustain a mad rush to the higher percentages. It would mean, he says, too much money chasing too few stocks. "There is a problem if everybody starts to do this," he says. "You very quickly run out of capitalization in the emerging markets."

Vague Formulas

The formulas for calculating the recommended percentages are far from exact. Kurt Brouwer of Brouwer & Jana-

chowski, a San Francisco investment-advisory firm, notes that the U.S. market accounts for about a third of the total world market. So, he says, it's "reasonable" for many individuals to have 50% of their investments overseas and a third of that in emerging markets.

S. Timothy Kochis, a San Francisco financial planner, uses guidelines based on an investor's age, which he subtracts from 80 and multiplies by two to determine the percentage of assets that should be invested overseas. As much as half of that could be in emerging markets, he says.

Under that formula, a 30-year-old investor could be totally invested overseas, with 50% in emerging markets. A 60-year-old would have 40% overseas, including 20% in emerging markets, and an 80-year-old would hold only domestic investments.

"The longer the time frame you've got, the more you can handle the risks," Mr. Kochis says.

Whatever the percentage, an investment in emerging markets "should be considered part of the section of the portfolio that's aggressive," says Catherine Gillis, editor of Morningstar Closed-End Funds, a Chicago newsletter. If you want "a small holding in China so you've got great cocktail conversation, I think that's fine," Ms. Gillis says. But, she adds, don't forget the risk. "This is a Communist country, for [heaven's] sake," she says.

Although financial professionals say that how much an investor puts into emerging markets depends on individual circumstances, they generally agree that individual investors should stick to mutual funds rather than try to pick stocks overseas. It's hard to follow overseas issues, they say, because there's far less disclosure in most emerging markets than there is in the U.S. "Think about the U.S. market in the 1880s," says Mr. Brouwer in San Francisco. "Forget securities regulation. They live on insider information."

Funds also make it easier to spread investments among a number of countries through one or more diversified funds or by buying shares of several different regional funds, which reduces the risk of a downturn in a single market. What's more, fund managers often structure a portfolio to hedge against sharp currency fluctuations, which would be difficult for most individual investors.

Stocks and Bonds

A trickier question is how to allocate emerging-market investments between stocks and bonds. The higher yields of emerging-market debt serve as "an income enhancer," says Neal Litvack, executive vice president of Fidelity Investments in Boston, who recommends that investors put up to 15% of the income portion of their portfolios in emerging-market debt. Fidelity launched its New Markets Income Fund in May; as of mid-July, it had about \$50 million in assets and a yield of 8.7%.

Fidelity says the fund is intended for "aggressive" investors, who can stand the "volatility of these rapidly growing markets." Judy Pagliuca, a fixed-income portfolio manager at Fidelity, compares emerging-market debt to junk bonds. "Some structures are riskier than others," she says. "Just as there's good company debt and bad company debt, there's a tier-

ing of emerging markets."

Although many investment advisers say stocks are more liquid than bonds in emerging markets, Ms. Pagliuca says that in a number of countries the bond markets are better developed. Certain Mexican bonds, for instance, backed by U.S. Treasury securities, are among the most widely traded international debt, she says.

But before rushing out to add emerging-market stock or debt to their portfolios, investors should find out how much they already own. A number of diversified mutual funds already have a portion of their assets in emerging markets. Fidelity's Asset Manager Fund, for instance, which allocates assets among stocks, bonds and cash, depending on market conditions, recently had about 20% of its nearly \$6 billion in assets in emerging markets, most of it debt. —Georgette Jensen, Robert McCough and Tom Herman.