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Experts Explore Investing in Emerging Markets at U.Va. Darden International Finance Conference

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by Carlos Santos

Newswise — Should you invest in emerging markets? You bet.

Are emerging markets risky? You bet — though not as risky as they once were.

These insights are from the University of Virginia Darden School of Business, where academics and practitioners from around the world attended the Darden International Finance Conference held 22 and 23 May, to examine the complicated workings of international markets.

The research of Darden's finance professors and other speakers helped attendees understand the evolution of emerging markets in a fast globalizing world.

"This is our 13th annual conference, and it gets better every year," said Darden Professor Rich Evans, one of the conference organizers.

Professors and practitioners presented 10 papers that investigated wide-ranging topics, such as international asset pricing, corporate governance and financing decisions. They were rewarded with feedback from the participants, which will help the authors improve the papers in preparation for submission to academic journals.

The keynote speaker at the conference, Campbell Harvey, the J. Paul Sticht Professor of International Business at the Fuqua School of Business at Duke University, has researched emerging markets for the past two decades. He says much has changed.

"There were few investors 20 years ago," said Harvey, a Canadian economist and one of the first researchers to study emerging equity markets and bond returns. "There was no history of portfolio investments. Any research that was available was rudimentary at best. Academic research was needed."

"The question then was whether to allocate any investment to emerging markets," he said. "Today, it's not whether to invest in emerging markets, but how much."

That doesn't mean Harvey has a specific investment allocation in mind. "In the end, it all comes down to judgment. There is no theoretical model that will tell you how much to invest." He asserts that most investment portfolios are underinvested in emerging markets.

Emerging markets — countries such as Brazil, Russia, India and

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China — have evolved to the point that some experts question whether there should be any differentiation between emerging and developed markets. Harvey, however, says emerging markets should still be considered a different asset class.

Harvey said that though emerging markets play a bigger role in the world's economy, there is a "huge difference in governance" manifested through less developed regulation, political instability and more corruption.

And while similarities between developed and emerging markets have increased, the integration of these markets into world markets is incomplete. "Segmentation is one reason to expect a [return] premium," said Harvey.

Currently, emerging markets account for more than 30 percent of world GDP, but they only account for 12.6 percent of the world's equity capitalization. The combination of incomplete integration and a smaller total equity investment than their contribution to world GDP would justify creates the chance to profit.

But has the risk profile of emerging markets decreased? "Yes, they probably have decreased in risk," said Harvey. "But these markets are still more risky than developed markets."

"The story is higher returns but higher risks," said Harvey. "There's higher risk because there's higher return."

"I have a very positive view for these [developing] countries in the long term," said Harvey. "The key is we want people to have the opportunity to compete and use their abilities. The major problem in emerging markets is that those opportunities are not around now. But they will be."

Harvey cited research that suggested the number of smartphone users will jump from the current 1.9 billion to almost 6 billion within five years. That will put powerful computers — and that means access to knowledge — in the hands of the masses in developing countries. "They had no opportunity in the past. They will have the opportunity in the future," he said.

Nicholas P. Sargen, chief investment officer for Fort Washington Investment Advisors Inc., also offered his view on international markets to conference goers. "I've been in the international markets for 43 years, but there's been nothing like the last five," he said.

Sargen added that while stocks in developed markets are "just marking time now," stocks in emerging markets are beginning to "come along."

He believes the financial crisis in the euro zone is over, at least for now. "The definitive answer from the financial markets is, yes, the crisis is over. There's no qualification." Stocks in Italy and Spain are 70 to 80 percent up over their lows.

"The euro zone is coming out of its double dip recession. We're even seeing a miniscule amount of growth," said Sargen.

As for China, he doesn't see it as a bubble about to burst, as many fear. "I don't see a complete flight out of China, though it's dropped from 10 percent growth to 7.5 percent growth. The economy is slowing." China, meanwhile is trying to slow its credit growth and liberalize its financial markets. "Bankruptcies will increase," said Sargen. "There will be lots of headlines in this story."

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