Predictable Risk and Returns in Emerging Markets*

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The emergence of new equity markets in Europe, Latin America, Asia, the Mideast and Africa provides a new menu of opportunities for investors. These markets exhibit high expected returns as well as high volatility. Importantly, the low correlations with developed countries’ equity markets significantly reduces the unconditional portfolio risk of a world investor. However, standard global asset pricing models, which assume complete integration of capital markets, fail to explain the cross-section of average returns in emerging countries. An analysis of the predictability of the returns reveals that emerging market returns are more likely than developed countries to be influenced by local information.

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