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BRICs fading out as MIST emerges

Emerging economies

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Not too long ago the BRICs – Brazil, Russia, India and China – were considered to be the top emerging markets for investors. But these economies are developing fast and some don't consider them to be emerging any more. So what are the newer developing economies investors could consider?

Clayton Daniel, a principal adviser with wealth management business Hillross Silverstone, says the BRIC countries are now considered "the usual suspects" of the emerging markets world.

"The new group, MIST, includes Mexico, Indonesia, South Korea and Turkey. These countries are slowly being considered to be potential investment sources," he says.

Ramana Rao, director of financial advice firm Metaplanners Wealth Strategists, says it can be a good idea, from a portfolio diversification point of view, to have a small exposure to emerging markets. He says an allocation of less than 5 per cent of the portfolio can make sense for some investors.

"Rather than picking winners and losers among emerging markets, we are more comfortable gaining exposure to these economies via an emerging markets index. It is a conservative strategy but carries less risk and that's important when dealing with markets that have historically been more volatile than developed markets," says Rao.

He says a method of further reducing the risk when investing in such markets is dollar cost averaging. This involves investing the same amount at regular intervals in an investment.

"This method ensures you don't invest all your hard earned money at one point and miss an opportunity to buy low if markets correct," he says.

Shane Quinn, director of unlisted property fund Quintessential Equity, says he has reviewed commercial property opportunities in Ireland, which he considers an emerging market. But he has decided against gaining exposure to this market.

In terms of investing offshore in emerging markets, he says: "I haven't found a market I would be comfortable backing at this stage. Longer term, if I see an opportunity in Ireland due to the fact that I have worked over there and know the market, I may look there. But at this stage I would be holding firm to stay in Australia."

Properly identifying the risks in these markets is essential, given investments in emerging markets are generally riskier – although they also carry higher potential rewards – than other markets. So how should you identify and manage risks in these countries?

Daniel believes the best way is to invest in fund managers that have a mandate to purchase first world equities that are expanding their business model into these newer economies.

In contrast, Rao believes the key to investing in emerging markets is to understand they will be more up and down in comparison to developed markets – and not to panic and sell out at the first hint of a downturn.

"Currency also plays a significant role for Australian investors when investing in world markets, which is why buying some insurance in the form of hedging makes good sense. This is easily done by selecting funds that are fully hedged – you will pay a fraction more in management fees but will also sleep better knowing that there is that extra risk protection," he advises.

The riskier profile of emerging markets also means it's essential to get as much information as you can before deciding to invest.

"There are professionals that are watching these markets every day," says Daniel.

"The best way to find out which fund managers are doing this well is to search for single-sector fund managers in international equities, and read their research. Morningstar provides a good starting point for this," he says.

Rao suggests turning to the financial press, which has a wealth of information on all markets. He says investors keen to obtain a good understanding of developing markets would do well to read financial publications regularly. Of course, the ASX website also has plenty of information on listed funds, including exchange-traded funds, many of which have exposure to emerging markets.

So how can retail investors identify warning signs they should not be investing in riskier markets? Daniel says even when it comes to investing in Australian equities, the risks are high and international equities are a step up the risky chain as retail Australian investors don't necessarily understand the cultural context of the companies in these countries.

An automotive plant in Turkey, a country tipped for EM investment. PHOTO:BLOOMBERG

"Emerging markets are even riskier as we have less information about their markets, and that information is not as transparent [as information about Australian businesses]," he says.

According to Daniel, investors should keep a close eye on macro-economic risks such as an unstable global environment, as money will generally flow from insecure geographical areas to safety, potentially affecting returns from emerging markets.

When it comes to property, Shane Quinn says clear warning signs are if people can't give straightforward investment strategies that can be mathematically calculated.

"Be very careful if people start talking about investing in property based on sentiment rather than on hard facts and property fundamentals. My advice would be to walk away from any such investment," says Quinn.

"The tell-tale warning signs of an investment is when people can't justify the property fundamentals in very simple calculations.

"If they have complicated structures you don't understand, do not invest in their model. The property strategy has to be simple, easily understood and transparent," he cautions.

Ultimately, says Rao, world economic instability, particularly in the US, will translate into more volatility in emerging markets and may be beyond the average investor's tolerance for risk.

"To invest in these markets is to accept that there will be greater fluctuation and that in uncertain times it will only get worse," he says.

"Carefully watching the goings on in the US is not a bad idea when considering an investment in emerging markets. Once you have done that you will have a better idea of the percentage of the portfolio that should be allocated to this sector."