CREATIVE PLANNING

Emerging Markets

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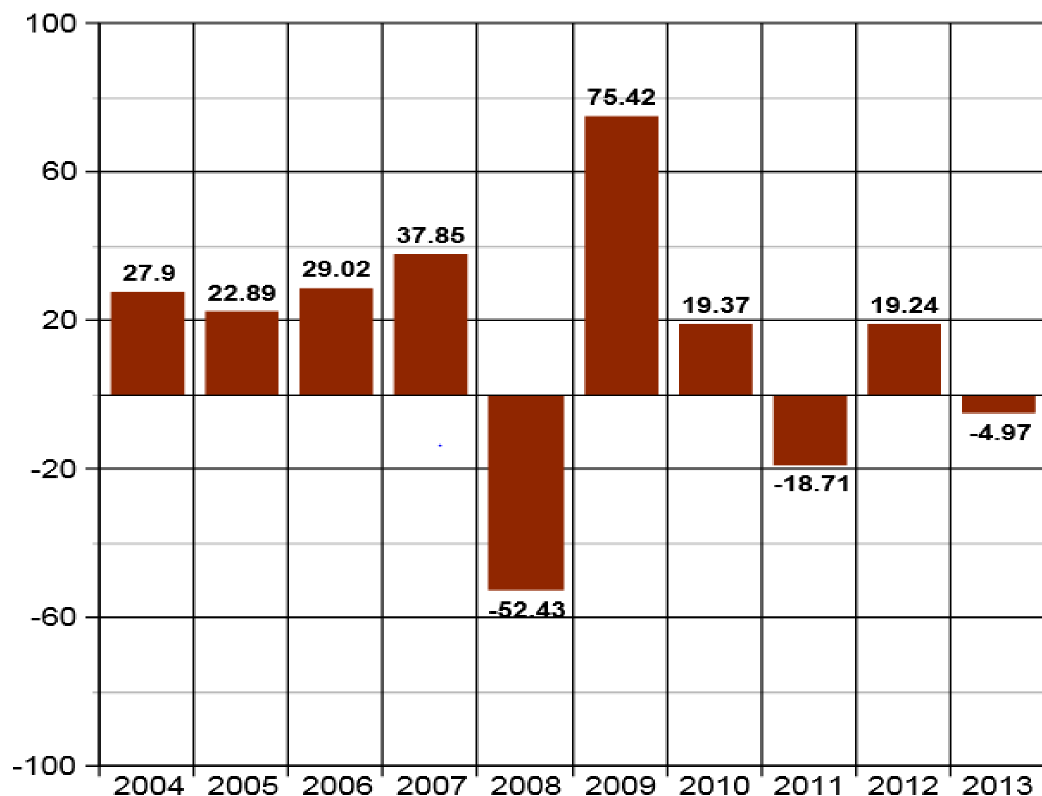
Investing in emerging markets is not for the faint hearted. It is so normal for emerging markets to be the best or worst performer over any given time period that it is often surprising when that isn't the case. The chart below shows the returns of emerging markets over the last 10 years. In 9 of the 10 years, emerging markets were either the best or worst performer among all major asset classes.

EMERGING MARKETS INDEX RATE OF RETURN



Source: FTSE/Vanguard

Investors who own emerging markets as an asset class expect to be rewarded for the risk over the long run. This is the same reason investors invest in bonds instead of cash, large cap stocks instead of bonds, or small cap stocks instead of large cap stocks. In all cases, the investor expects to get a better return over the long run in exchange for the added volatility. This, of course, is not a guaranteed outcome, but rather one based on reasonable expectations and the logic of markets.

So who should own emerging markets as a portion of their portfolio? An investor in emerging markets needs

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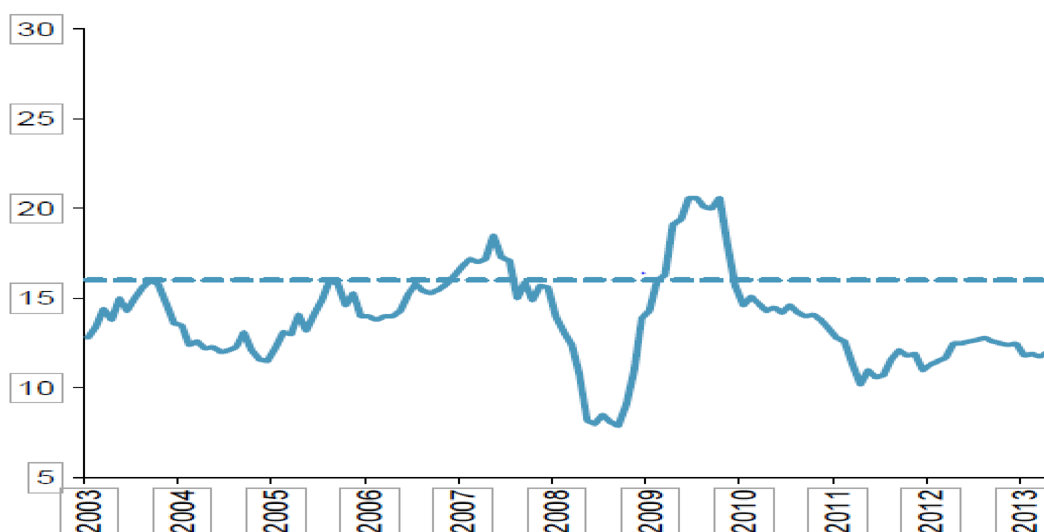
to meet two criteria.

First, you might immediately think it is for someone who won't need their portfolio to meet their income needs for 10 years, but that is not the case. Emerging markets are appropriate for investors who will not need to access that particular portion of their portfolio over the next 10 years. For example, an investor with $3 million who spends $150,000 per year, can maintain an allocation to emerging markets and other riskier assets like small cap stocks because their income needs will be met from other parts of their portfolio. While the portfolio has immediate and intermediate needs, the emerging markets portion won't be needed for many years.

Second, once we know an allocation to emerging markets is appropriate, the client must have the risk tolerance to handle the volatility. Emerging markets move wildly and unpredictably, and it is not uncommon for 20% swings to occur multiple times in a very short period of time. If an investor gets excited by dips because they can buy more, then it is a great fit. If it makes the investor want to throw up, then not so much. Overall, any portion allocated to emerging markets should have a long term outlook and the investor must understand its role in the portfolio.

At present, emerging markets present a remarkable value. The current P/E ratio is dropping close to 10, its second lowest level in 15 years, and approaching the 2009 crisis levels. The chart below illustrates how far it is trading below historical averages. This does not mean it is due for a recovery any time soon. While emerging markets as an asset class have always recovered fully and gone on to new highs, it is not uncommon for it to underperform or outperform for long periods of time.



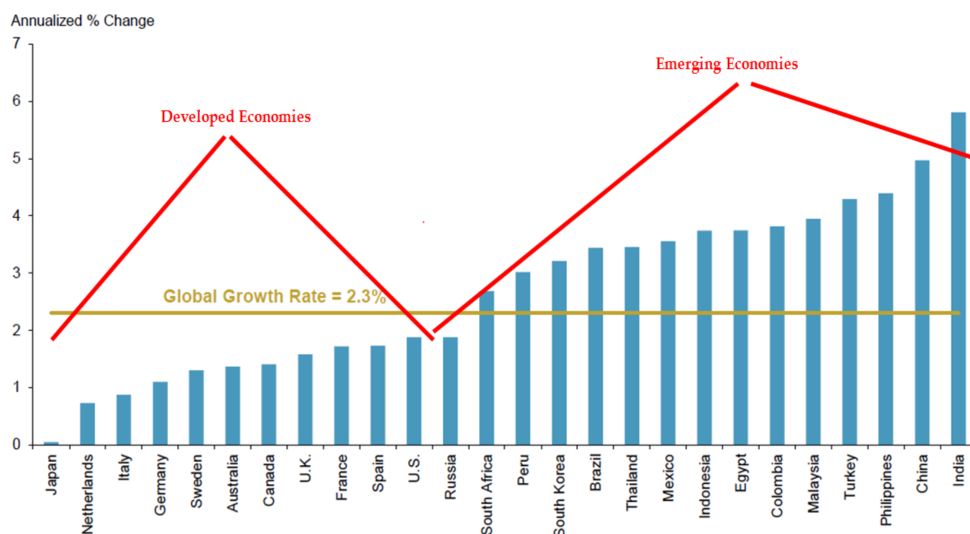
Source: FactSet

It is important to note that while emerging markets sounds like one stock, it in fact represents a very broad investment. The emerging markets position we use in our portfolio represents over 900 companies in over a dozen countries spread across several continents. In other words, if you own this position you own a stake in

hundreds of companies that make real things that real people buy. The chart on the next page is representative of just some emerging market countries, and the chart makes it clear they don't necessarily all move in the same direction all the time. Our emerging markets position never bets on one continent, one country, or a handful of stocks. It is a broad based investment betting on the emergence of developing countries.

Keep in mind these economies are still small, and their publicly traded markets reflect that reality. The entire market capitalization of Mexico is about the same as that of Pfizer, Chile is similar to Costco, South Africa to Johnson & Johnson, Egypt to Dr. Pepper, and Russia to Procter & Gamble. Think of emerging markets as the next generation in their teenage years. We wouldn't want to bet the future on one teenager, and when we look at teenagers as a group, frankly there are times we wouldn't want to bet on them either. However, history tells us our teenagers are going to grow up and take the world to places it hasn't been before. They just need time to develop. Yes, there will be those that don't contribute much, or even anything at all, but as a group, it is a safe bet when coupled with time. I, for one, am thankful there is not a CNBC type station with pundits telling me how things will go with teenagers next week or even this year. Emerging markets are like emerging adults. Give them some time. The following graph provides an idea of the expected growth in emerging countries.

Thank you for the introduction to your friends and colleagues, and for your continued confidence.



Source: Fidelity Investments (AART) with Creative Planning Commentary

Finally, as we step back, there is an even clearer picture. There are over 1 billion people emerging from poverty in the world, most in emerging economies. These people, like everyone, like to buy stuff. These countries are called emerging markets, not submerging markets, and their name implies we expect them to emerge into developed economies over time. If you think these countries will in fact "emerge", the investment position will likely do what it is supposed to do, which is reflect the growth of these emerging economies.

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