Investing in Emerging Markets: How to Break Free from the Herd

By: Ruth Williams Investing and Talking Points

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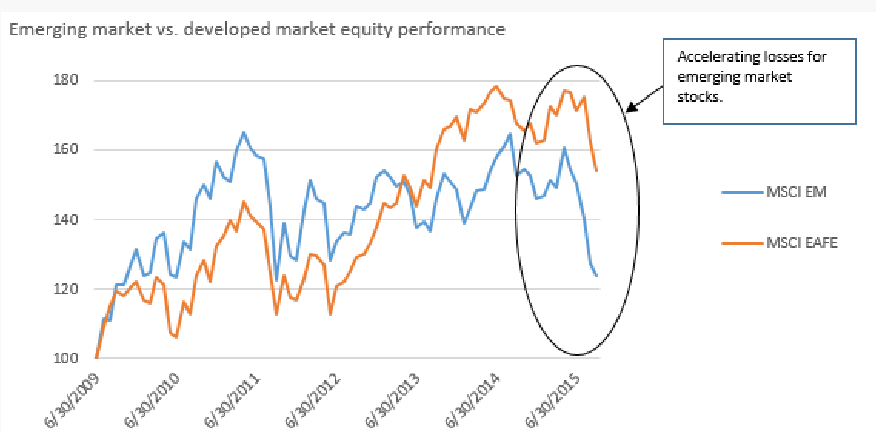
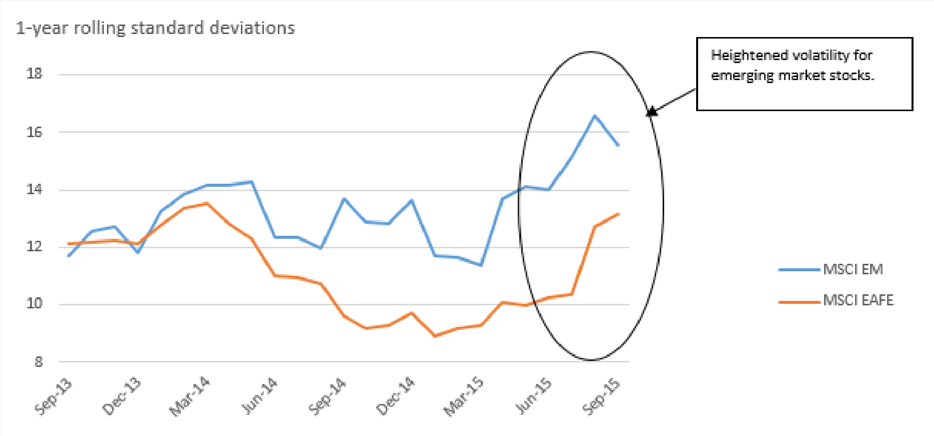
A basic tenet of contrarian investing is the belief that the crowd is always wrong—or at least wrong enough so you might be able to turn a profit by betting against the herd.

Emerging markets—Opportunity for the sufficiently brave or fundamentally foolish

Emerging markets enjoyed a strong rally after the financial crisis, but have since endured a rough couple of years. More recently, emerging market losses accelerated and volatility peaked as investors feared **the effects of a slowdown in China**, **weak commodity prices**, and higher interest rates in the United States. Year-to-date, emerging market stocks plunged 15.22% through the end of September versus a more modest 4.91% decline for their developed market peers during the same period.



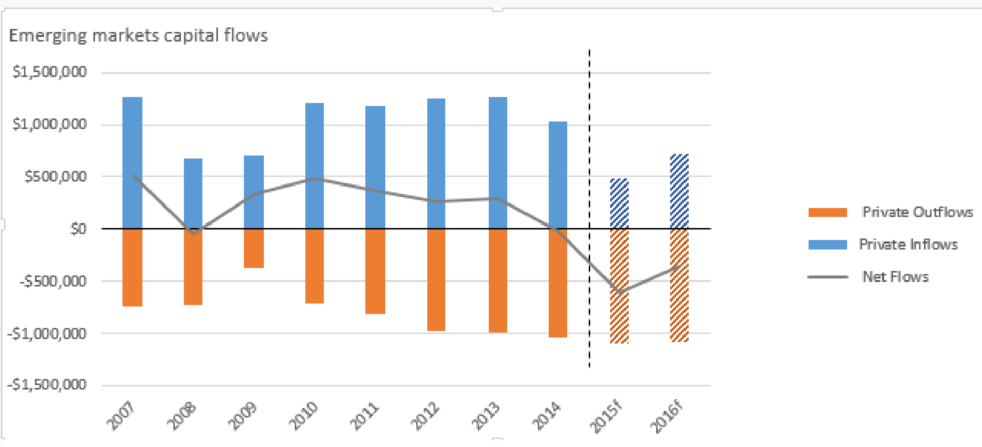
Source: Morningstar Direct. Emerging market stocks are represented by the MSCI Emerging Markets Index and developed markets by the MSCI EAFE Index. Performance is scaled to 100 as of 9/30/2015.



Source: Morningstar Direct. Emerging market stocks are represented by the MSCI Emerging Markets Index and developed markets by the MSCI EAFE Index.

The herd mentality

Investors are heading for the door en masse. According to the **Institute of International Finance (IIF)**, an industry group, emerging markets are on track to sustain net outflows for the first time this year since the financial crisis.



Source: IIF. Based on non-resident capital inflows and resident capital outflows (excluding reserves.) Data for 2015 and 2016 are based on forecasted estimates.

Opportunity is what you make of it

> *"Be fearful when others are greedy and greedy when others are fearful"*
>
> —Warren Buffett

While the ride down may be painful, indiscriminate selling can lead to inefficient markets. And where there's inefficiency, there's often opportunity—if you know where to look for it.

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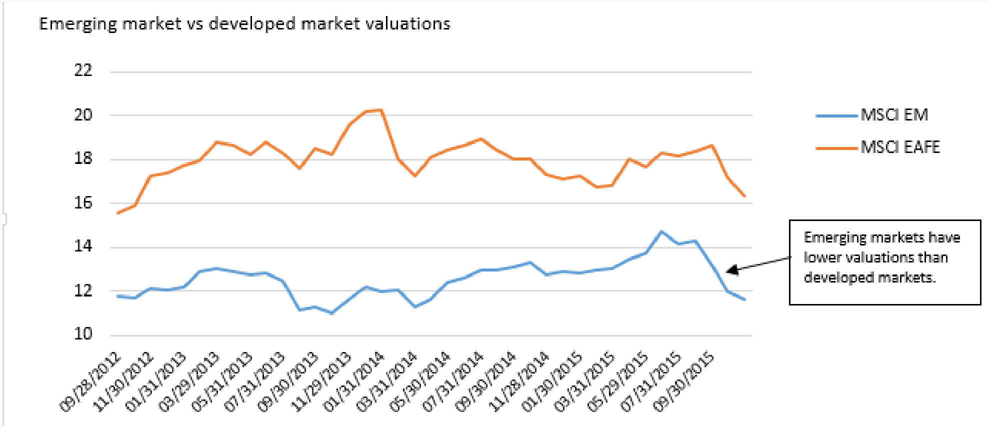

Source: Bloomberg. Valuations are based on price to earnings ratios. Emerging market stocks are represented by the MSCI Emerging Markets Index and developed markets by the MSCI EAFE Index.

The price-to-earnings (P/E) ratio is a popular valuation measure that can help investors determine how cheap or expensive an investment is. In general, the higher the P/E ratio, the more the market is willing to pay for each dollar of a company's earnings. In an inefficient market where the sentiment is overly-bearish and pessimistic, lower P/E ratios can indicate the potential for undervalued investment opportunities.

Active managers who can effectively generate returns that can justify the higher risks associated with emerging markets investing have the potential to really shine in volatile markets. And while there may be the potential for significant reward, make no mistake: emerging markets investing, especially in today's volatile environment—is not for the faint of heart.

Investing in emerging markets today often requires deep patience and enduring conviction.

If you envision yourself as an adventurous bargain hunter and are willing to take the leap into emerging markets, we offer the following suggestions:

- **Be selective:** Country, company and investment type matter. Emerging markets are often grouped together, but they are no longer a homogenous asset class. There are some important differences between the various economies and types of investments.
- **Think long-term:** Longer time horizons may be needed to ride out the higher ups and downs.
- **Stay diversified:** The ability to tap into multiple asset classes, sectors and investment types in single portfolio—including exposure to developed and emerging markets—can be an effective way to dampen volatility and improve risk-adjusted returns.

Explore opportunities that can give you exposure to emerging markets:

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