



REACHING FOR GROWTH

Crack open emerging market opportunities.

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These days, emerging markets are the flavour of the month. Emerging stock market performances attest to that and much of the excitement is well founded. After all, given the premise that above-average growth in volumes, sales, and earnings leads to above-average market returns, emerging markets surely do exhibit this growth profile. For instance, as Russia's economy expands from \$2,000 in gross domestic product (GDP) per capita, more and more people will have the discretionary income to afford, for example, a bottle of Heineken beer. The Russian economy has grown at 10% a year recently, partly because it has a greater capacity to grow than the developed world. Contrast Russia's \$2,000 figure with the U.S. GDP per capita of \$35,000. Clearly, this sort of growth potential is the reason to be exposed to emerging markets. Importantly, however, the Canadian investor should bear this growth enhancement objective in mind and not simply go emerging for emerging's sake. What are the risks involved in emerging markets?

To start, demand growth in emerging markets will be volatile. Recent history is littered with examples of this. In the two years following 1996, the South Korean economy practically halved while most of the developed world economies actually grew. Following that, it took a further five years for the South Korean economy to get back to where it was in 1996.

A second layer is political risk. Fledgling economic systems seem inherently associated with equally young political structures. Currency risk is another factor. In 1998, the value of the Malaysian Ringgit was halved relative to Western currencies. No matter how secure and sound the Malaysian investments one held at the time, all else being equal, those investments were cut in half.

Then comes the question of corporate governance and disclosure. Many a capital allocation decision in emerging markets is based more on kinship than stewardship.

Indeed, the likelihood that the investor is even aware of transgressions is greatly reduced by often-lax reporting standards of emerging market regulatory bodies. Yet another risk is the illiquid nature of the emerging stock markets. For example, the biggest Eastern European stock market today is Poland, and the biggest stock therein is PKO Bank. The daily traded volume of this company is equivalent to that of the 47th biggest Canadian company, the Canadian Tire Corporation Limited.

To be sure, there are sizable risks in emerging stock markets and perhaps most ominous of all, they often occur simultaneously. For example, Economy X starts to slow because of increased energy costs and Government X nationalizes a large local company. A run on the currency ensues and every foreign investor is trying to squeeze out of a very narrow liquidity doorway.

Ultimately, the growth of the emerging economies of the world is real and very attractive. One way to take part in the growth potential of emerging markets while avoiding some of the risks is to invest indirectly in companies that stand to benefit from this growth.

Reach for a cold one

A good example is Heineken Brouwerijen B.U., which has 40% of its beer volume coming from emerging Eastern Europe, and another 10% apiece from Asia and Africa. At the same time, 75% of sales come from less volatile, western markets. When it comes to political and currency risk, one would indeed have to dig deep to see the last time the Dutch government nationalized a business. In addition, the stock trades in Euros, a stable currency if ever there was one. Any question of corporate governance standards at the conservative 150-year-old company would be moot, and the stock's liquidity is equivalent to that of TD Bank Financial Group in Canada.

Is this an example of growth without the high risk? Food (drink) for thought. ■