Investing in Emerging Markets

- COMPASS has long recommended exposure to emerging market stocks due to the underlying growth prospects of their economies relative to the developed world.
- More recently, COMPASS began introducing emerging market bonds to some client porfolios because, in part, of the financial strength of many of these countries.

Emerging-market economies offer tempting rewards and are becoming more standard among investors willing to take on additional risk. Commonly called developing-market economies, they are in transition but are beginning to see a substantial increase in living standards and income, rapid economic growth and a relatively stable currency. They can be small or large economies and can be found all over the globe. Examples include China, India, Korea and Thailand in Asia; Poland, Egypt, and Turkey in Europe and the Middle East; and Brazil, Chile and Mexico in Latin America. As of May 2010, MSCI Barra identified 21 emerging countries worldwide.

Since these economies are still developing, the risk of an emerging-market investment is higher when compared with a developed market. Some of these risks include currency fluctuations, foreign taxation and political, social, and economic upheaval. However, such added risk comes with the potential for higher returns.

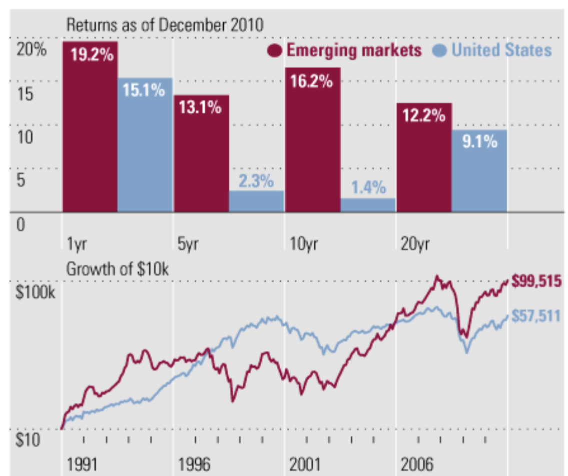
Perhaps the easiest way to include emerging markets in a portfolio is to buy an emerging-markets mutual fund. This is a mutual fund that holds various investments in emerging countries, bringing you the added benefit of diversification. Make sure to read the mutual fund's prospectus very carefully before investing or sending any money.

Another way to invest in emerging markets would be to buy stocks of foreign companies directly—much more difficult and risky to do on your own. You may also hear the term ADR connected with international investing. It stands for American Depositary Receipt, and it is an instrument allowing the stock of a foreign company to trade on a U.S. exchange. However, no matter how you decide to invest, always keep in mind the risks associated with international and emerging-market investments.

The graph illustrates the historical short- and long-term performance of emerging markets compared with U.S. markets. Emerging markets posted very respectable returns, beating those of the U.S. market in every time period. However, these returns came with additional risk, as shown by the volatility of the line graph. A hypothetical $10,000 invested in emerging markets would have grown to $99,515 over this 20-year time frame, compared with $57,511 for domestic investments.

While the emerging markets' ending wealth value easily surpassed that of the U.S. investment, it accumulated over a rather long time horizon. Note that emerging markets can experience a much greater upside and often a deeper downside in any particular year (2008, for example). Consequently, this type of investment is more appropriate for long-term investors who can handle potentially large fluctuations in returns.

Undeveloped Opportunities: 1991–2010



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Emerging-market investments are riskier than developed-market investments. Liquidity is typically lower in emerging markets than in developed markets. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed.

Source: U.S. stocks are represented by the Standard & Poor's 500® index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Emerging markets are represented by the Morgan Stanley Capital International Emerging Markets Index.