SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Emerging

Investors have ventured from home markets over decades, but often to other markets with highly developed economies, property rights and rules of law. Interest grew in markets yet to fully develop these traits as investment opportunities emerged. By the late 1980s, sufficient markets and supporting research had emerged to attract investor capital. Behind these markets were economies generally growing more rapidly than those of developed markets. While more rapid growth could lead to higher investment returns, less stable governments, more volatile currencies and inconsistent jurisprudence meant higher risks. A review of how markets have emerged may be informative for investing ahead.

PERSPECTIVE

When research firm MSCI launched its emerging markets stock index in 1988, 10 countries were included. As shown in Chart I, the MSCI index today includes 24 countries. Over the past 36 years, 27 countries were added to the index while 13 countries exited. 12 countries moved up from emerging status. The collapse of Russia's financial markets as it launched a war in Ukraine led to its removal from the index in 2022. In early years, especially after the fall of the Soviet Union, regional weighting was highest in Europe and the Americas. Today, the Asia-Pacific region dominates with a 78% weighting spread across eight emerging markets.

The emergence of China's economy since the 1980s is well documented, growing at 13% per year since 1990. With the rate of world economic growth at 5%, China's economy became the second largest at 18%. The U.S. is largest at 25%. China's financial markets have remained classified as emerging as not all attributes of developed markets prevail. Notable is the central government's role in market functions and regulation. Nevertheless, as China's economy has grown, so has the contribution of its stock market return to the overall return of emerging markets stocks. Chart II shows the increase in China's contribution to emerging stock markets, rising from 2% in 2001 to a high of 38% in 2022. Under-performance since then brought the contribution rate down to 31%.

The record of emerging markets stock returns over time has been mixed. Chart III shows emerging markets stock returns relative to returns of the total U.S. stock market. The pattern has been one of long periods of emerging markets out-performance followed by long periods of under-performance. For rolling three-year returns, emerging markets stocks out-performed U.S. stocks only twice in the past 22 years. A more sustained period of out-performance may have been interrupted by growing trade disputes with China and global disruptions resulting from the pandemic. While China's economic growth has slowed materially, strength in other emerging economies may underwrite a period of emerging market stock out-performance once again.

INVESTMENT IMPLICATIONS

Investment in emerging markets stocks is predicated on return opportunities, risk considerations, and the expected contribution to overall portfolio outcomes. The case for emerging markets stocks rests in part on the underlying growth prospects of respective economies. Emerging markets stock returns also include a currency component. Relative returns may struggle during periods of U.S. dollar relative strength. An allocation to emerging markets may be warranted but it must be actively managed along with all other portfolio weightings.

CHART I

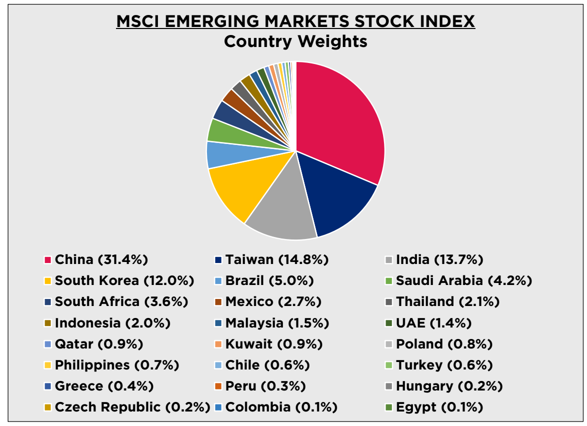

CHART II

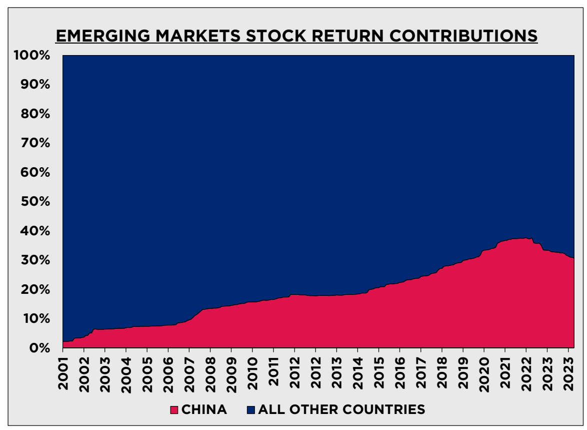

CHART III