THE LITTLE BOOK

EMERGING MARKETS

How to Make Money in the World's Fastest Growing Markets

MARK MOBIUS

OF EMERGING MARKETS

Little Book Big Profits Series



In the *Little Book Big Profits* series, the brightest icons in the financial world write on topics that range from tried-and-true investment strategies to tomorrow's new trends. Each book offers a unique perspective on investing, allowing the reader to pick and choose from the very best in investment advice today.

Books in the Little Book Big Profits series include:

The Little Book That Still Beats the Market by Joel Greenblatt

The Little Book of Value Investing by Christopher Browne

The Little Book of Common Sense Investing by John C. Bogle

The Little Book That Makes You Rich by Louis Navellier

The Little Book That Builds Wealth by Pat Dorsey

The Little Book That Saves Your Assets by David M. Darst

The Little Book of Bull Moves by Peter D. Schiff

The Little Book of Main Street Money by Jonathan Clements

The Little Book of Safe Money by Jason Zweig

The Little Book of Behavioral Investing by James Montier

The Little Book of Big Dividends by Charles B. Carlson

The Little Book of Bulletproof Investing by Ben Stein and Phil DeMuth

The Little Book of Commodity Investing by John R. Stephenson

The Little Book of Economics by Greg Ip

The Little Book of Sideways Markets by Vitaliy N. Katsenelson

The Little Book of Currency Trading by Kathy Lien

The Little Book of Stock Market Profits by Mitch Zacks

The Little Book of Big Profits from Small Stocks by Hilary Kramer

The Little Book of Trading by Michael W. Covel

The Little Book of Alternative Investments by Ben Stein and Phil DeMuth

The Little Book of Valuation by Aswath Damodaran

The Little Book of Bull's Eye Investing by John Mauldin

The Little Book of Emerging Markets by Mark Mobius

The Little Book of Hedge Funds by Anthony Scaramucci



EMERGING MARKETS

How to Make Money in the World's Fastest Growing Markets

MARK MOBIUS



John Wiley & Sons Singapore Pte. Ltd.

Copyright © 2012 by Mark Mobius.

Published by John Wiley & Sons Singapore Pte. Ltd. 1 Fusionopolis Walk, #07-01, Solaris South Tower, Singapore 138628

All rights reserved.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as expressly permitted by law, without either the prior written permission of the Publisher, or authorization through payment of the appropriate photocopy fee to the Copyright Clearance Center. Requests for permission should be addressed to the Publisher, John Wiley & Sons Singapore Pte. Ltd., 1 Fusionopolis Walk, #07-01, Solaris South Tower, Singapore 138628, tel: 65-6643-8000, fax: 65-6643-8008, e-mail: enquiry@wiley.com.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the Publisher is not engaged in rendering professional services. If professional advice or other expert assistance is required, the services of a competent professional person should be sought. Neither the author nor the Publisher is liable for any actions prompted or caused by the information presented in this book. Any views expressed herein are those of the author and do not represent the views of the organizations he works for.

Other Wiley Editorial Offices

John Wiley & Sons, 111 River Street, Hoboken, NJ 07030, USA
John Wiley & Sons, The Atrium, Southern Gate, Chichester, West Sussex, P019 8SQ,
United Kingdom

John Wiley & Sons (Canada) Ltd., 5353 Dundas Street West, Suite 400, Toronto, Ontario, M9B 6HB, Canada

John Wiley & Sons Australia Ltd., 42 McDougall Street, Milton, Queensland 4064, Australia Wiley-VCH, Boschstrasse 12, D-69469 Weinheim, Germany

ISBN 978-1-118-15381-9 (Hardcover) ISBN 978-1-118-15370-3 (ePDF) ISBN 978-1-118-15382-6 (Mobi) ISBN 978-1-118-15383-3 (ePub)

Typeset in 12.75/15.5, CgCloister by MPS Limited, Chennai, India Printed in Singapore by Markono Print Media Pte. Ltd.

10 9 8 7 6 5 4 3 2 1

To my mother and father for giving me the opportunity to learn

Contents

Introduction	X1
Author's Disclaimer	xvi
Chapter One	
What Are Emerging Markets?: An Investment	
Opportunity Not to Be Missed	1
Chapter Two	
Top Reasons for Investing in Emerging	
Markets: Growth and Diversification	9
Chapter Three	
Discovering Frontier Markets: Don't Miss	
the First Mover Advantage	27
Field Note: Kazakhstan	34

[VIII] CONTENTS

Chapter Four	
Getting Down to Business: How to Invest	
in Emerging Markets	37
(I)	
Chapter Five	
Is There a Right Way to Invest?: Comparing	
Investment Styles	48
Chapter Six	
Researching Emerging Markets:	
Always Keep an Open Mind	57
Field Note: Czech Republic	71
Chapter Seven	
The Reality of Risk: And Why Not to Fear It	75
(I)	
Chapter Eight	
Timing Market Factors: Currencies: Why a	
Crisis Can Be the Best Time to Buy	85
Field Note: South Korea	93

Chapter Nine	
It's Called Volatility: What Goes	
Up Comes Down, and What Goes	
Down Comes Back Up	97
Chapter Ten	
The Importance of Being Contrary:	
Don't Follow the Crowd	105
Chapter Eleven	
The Big Picture and the Small Picture:	
A Case Study of Russia	113
Field Note: Russia	126
Chapter Twelve	
Pri·va·ti·za·tion: The Trend That	
Can Bring Huge Opportunities	129
Chapter Thirteen	
Boom to Bust: How, When, and Why?	139
Chapter Fourteen	
Don't Get Emotional: How to Profit	
from the Panic	151
II OIII CIIC I CIIIC	1/1

[x] Contents

Chapter l'ilteen	
Turning Fear into an Advantage Instead of a	
Disadvantage: A Case Study of Thailand	161
Chapter Sixteen	
The Crisis Bargain Bin: Taking the	
Long-Term View in the Aftermath	
of a Crisis	169
Chapter Seventeen	
Overcoming Irrational Market Panic:	
Learning to Be Objective	181
Field Note: Brazil	191
Chapter Eighteen	
The World Belongs to Optimists: Golden	
Investment Attributes and Rules	197
Acknowledgments	205
About the Author	207

Introduction

ONE OF THE MOST frequent questions I get asked is: "When's the best time to invest?" The answer is: The best time to invest is when you have money. The reality is that market timing is impossible, and since purchasing ordinary shares of companies traded on a stock exchange (which is called equity investing) is the best way to preserve value, rather than leaving money in a bank account, it is most advisable to just get going. Don't wait for the fabled perfect moment. That answers the question of when to buy, but what about knowing when to sell? My advice on that issue is that an investment should not be sold unless a much better investment has been found to replace it.

"The best time to invest is when you have money."

-Sir John Templeton

To me, more important than the question of when to invest is the question of where to invest. My bias rests with emerging markets. Emerging markets are the financial markets of economies that are in the growth stage of their development cycle and have low to middle per capita incomes. The opposite of an emerging market is a developed market, the financial market of a mature economy with a high per capita income.

Emerging markets possess a greater upside in the long term because of their strong economic growth. Specifically, they offer the best opportunity for higher returns and diversification. It might also surprise you to know that emerging economies account for about two-thirds of the world's land mass—that's a large part of the world that you can't afford to miss out on!

Emerging markets are close to my heart; having worked in emerging countries for more than 40 years, I've learned a great deal about how their markets work and where money can be made. This book not only introduces you to emerging markets, but also describes where, why, and how you can invest in them. I also give you

insights into individual markets and some of the crises that these markets have withstood; I hope to equip you with information that will help you better navigate through your search for investments in these markets.

But while we're on the topic of when, I'd like to share something I've learned over the years: Bull markets run longer and gain more in percentage terms than bear markets, which last a short period of time and fall less in percentage terms. This is an important overall phenomenon of which to be aware, because it is a factor when deciding whether to invest.

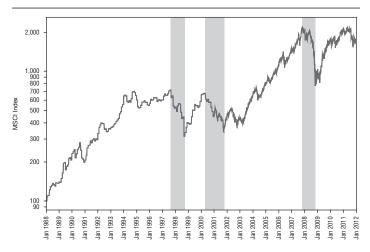
Market timing is difficult, but it is generally safe to assume that a bull market is coming eventually and that the stock market will rise above its previous highs during that time. Moreover, if you're strong enough to hold your own in both up and down markets, the best thing to do is to buy more stocks when the bear market comes, because it is going to be shorter in duration than the bull market. Investors who bought during the last bear market in 2008, for example, in many emerging markets doubled their money. Of course we'll have more bear markets going forward, but the lesson is clear.

Before diving in, let's look at an example. In January 1988, a bull market run in emerging markets began that lasted for about nine and a half years and saw the index climb over 600% from its starting point. The ensuing

bear market lasted just over a year and saw a loss of more than 50% in the value of the index. The next bull market began in September 1998, and over the course of a year and a half, gained over 110% in value. This was followed by a similar-duration bear run in which prices declined by close to 50%.

The point is clear, and can be demonstrated again from October 2001 to November 2007, when the bull market returned more than 530% in just over six years,

The Ups and Downs (but Mostly Ups) of the MSCI Emerging Markets Index



Note: Bear market based on 30% decline from the peak and bull market based on 30% increase from the bottom.

and was followed by a bear market that lost 65% in the subsequent 12 months.

Throughout the book you'll find Field Notes from my recent trips to countries considered to have emerging or frontier equity markets. These notes highlight industries to watch for and offer a glimpse into the sentiment there.

While there is no simple secret, blueprint, or road map to guarantee long-term success in emerging markets, there are plenty of good, solid lessons such as diversification, taking a long-term view, focusing on fundamentals, and tolerating market volatility. These lessons and more are what I have tried to put together in this book. I only hope that this Little Book can be your guide to big profits in emerging markets.

Author's Disclaimer

THE VIEWS EXPRESSED IN this book are solely my own, and do not necessarily represent the views of my employer.

The opinions expressed should not be relied upon as investment advice or an offer for a particular security. These opinions and insights may help you understand our investment management philosophy.

Statements of fact included in this book are from sources considered reliable, but the author makes no representation or warranty as to their completeness or accuracy.



What Are Emerging Markets?

An Investment Opportunity Not to Be Missed

WHILE I WAS STUDYING economic development at MIT in the early 1960s, the term *underdeveloped countries* was still in use, while more palatable euphemisms like *developing countries* were just coming into being.

The term *emerging markets* entered the vocabulary of the investment world in the late 1980s. The International

Finance Corporation defined an emerging market this way: "A market growing in size and sophistication in contrast to a market that is relatively small, inactive, and gives little appearance of change." At the time, the term was a declaration of hope and faith on the part of those of us who were studying emerging stock markets, because many of these markets-such as those of Argentina, Peru, and Venezuela—were submerging faster than they were emerging.

The Name of the Game

The purview of international portfolio investors was quite limited in the early days. In fact, if the concept of emerging markets had been current at that time, Japan would probably have been placed in that category. In the 1960s, investing in Japan was considered to be a risky and pioneering adventure; it was known as a land of cheap and shoddy exports, weak currency, and an unstable political future.

When Sir John Templeton asked me to manage the first emerging markets fund in 1987, a universally accepted operational definition of an emerging market did not exist. Intuitively it was known that emerging implied developing or underdeveloped, but it wasn't possible to ascertain what the cutting-off point for "emerging" versus "emerged" markets would be. However, the World Bank's classification of "high-income," "middle-income," and "low-income" countries on the basis of per capita income was a good start. The middle- and low-income countries were considered to be "emerging."

Since 1987, when that original list of emerging markets was compiled from World Bank data, there have been a number of changes in the per capita income rankings of countries, with countries moving into new categories.

For example, the matter of countries with huge natural resources in the developing world, particularly in the Middle East, had to be addressed. While these countries clearly could not be classified as developed because of the low levels of infrastructure and income distribution at that time, they often had high per capita income levels due to the strong exports of resources such as oil and gas. Thus, although such countries as Qatar and Kuwait had per capita incomes significantly higher than the low- and middle-income countries, the distribution of that income was such that general living standards had not reached developed country status.

Some of the emerging country stock markets are well developed and are considered by some international investors as not belonging to the emerging country category. For example, Hong Kong is considered by a number of international investors as one of the world's major stock markets and therefore is not included in their lists of

emerging markets. One pension fund manager said, "I don't consider Hong Kong an emerging market because it's easy to invest there and it's very liquid." However, when you consider the fact that Hong Kong is part of China, which is in the middle per capita income category, it is clearly in the emerging country category. Another important factor that needs to be taken into consideration is that in the case of many of the listed companies in Hong Kong, a large part of their earnings are generated in China; thus it would be mistake not to include those opportunities in the emerging market category.

Emerging markets are the financial markets of economies that are in the growth stage of their development cycle and have low to middle per capita incomes.

Emerging, Emerging, Emerged!

Another question: When does a stock market cease to be an emerging market? As emerging country income levels rise and emerging stock markets become more developed and easily accessible to all international investors, we then face the challenge of deciding which countries or markets

should be deleted from the list and which should be added. For example, there has been much talk of whether South Korea and Taiwan should graduate to the status of developed markets.

The emerging markets list will continue to change as economic and political situations evolve around the globe. For now, though, emerging market countries are considered to include those classified to be developing or emerging by the World Bank, the International Finance Corporation, the United Nations, or the countries' authorities, as well as countries with a stock market capitalization of less than 3% of the MSCI World index. These countries are typically located in Asia (excluding Japan), the Middle East, Eastern Europe, Central and South America, and Africa. Of all the markets, about 170 countries meet these conditions today.

At first glance, it may seem that the range of countries is prohibitively diverse for serious investment analysis. But there were, and still are, practical factors that serve to reduce the list for investors. Many countries were excluded as initial investment possibilities because of a number of barriers, such as foreign investment restrictions, taxation, and the lack of stock markets. Gradually more and more countries finally abandoned the socialist/communist economic model and came to realize that a market economy would yield faster growth. This resulted