MARKET COMMENTARY

SEAFARER®

Emerging Markets Briefing

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Seafarer addresses key questions about emerging markets investing and how U.S. investors can integrate the asset class into long-term portfolios.

What role can emerging markets play in U.S. investors' asset allocations?

The emerging markets asset class can serve two useful roles in a long-term investor's portfolio:

Emerging markets offer a prospective source of diversified growth within a long-term investor's portfolio. During much of the last 15 years, the concept of "decoupling" was in vogue for the emerging market asset class, but was overstated and misapplied. However, Seafarer believes that two recent structural changes – reduced reliance on exports and independent monetary policy – might finally allow the markets to "decouple" from the developed world. "Decoupling" is now relevant, for the first time.

A high-quality, income-producing portfolio of emerging market securities (dividend-paying stocks and bonds) can act as a useful source of diversification (or hedge) against the U.S. dollar. Seafarer believes that long-term investors should seek exposure to productive assets with meaningful growth potential, and that are capable of generating income in currencies other than the U.S. dollar.

How should long-term investors integrate the emerging markets asset class into their portfolios?

The emerging markets are likely to remain volatile for the foreseeable future. Risk appetite must dominate any consideration of the asset class. Seafarer believes that investors should consider two key factors:

Long-term time horizons are essential. Given the volatility of the asset class, due especially to heightened currency risk, Seafarer suggests that investors adopt a minimum investment horizon of five years.

Investors should manage U.S. dollar versus non-U.S. dollar exposures in their portfolios. Rather than initially allocating capital among traditional "asset classes" (e.g., domestic stocks, foreign stocks, bonds, real estate), Seafarer believes investors should measure the portion of their assets that are principally denominated in U.S. dollars versus those assets that are not. After matching U.S. dollar assets against U.S. dollar liabilities, a portion of the surplus capital (e.g., 10% to 30%) can be allocated to the emerging markets.

What are notable developments in China's rise as a key investable market?

Seafarer addresses China's growing financial markets and international influence in several recent commentaries:

- In the Second Quarter 2018 Portfolio Review[1] for the Seafarer Overseas Growth and Income Fund, Andrew Foster writes: "Under President Xi Jinping's administration, China has moved decidedly to position itself as a new global hegemon, with an enormous and well-educated populace, the world's largest economy, burgeoning international influence, and growing military might. In my estimation, this thrust to become a new hegemon, alongside the U.S., has structurally altered the manifestation of risk and reward in the developing world. Chinese companies have the scope to grow faster and become larger than ever before; Chinese capital markets have the propensity to become deeper and more liquid than previously imagined; and China's currency, the renminbi, has exhibited greater stability at a higher price than most pundits ever thought possible."
- In the white paper *China's Tech Rush*,[2] Nicholas Borst discusses the country's strategic technology campaign: "China's campaign to advance its technological capabilities has the potential to transform many emerging high-tech industries through an unprecedented level of government support and cooperation with the private sector."

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- In the white paper *One Belt, One Road – Many Motives*,[3] Steph Gan addresses the financial incentives and risks of China's Belt and Road initiative. Steph writes that this ambitious vision for global trade and infrastructure development "frames China as the geographic and financial center, with ties radiating toward Europe, Asia, and Africa."
- In the white paper *The Evolution of China's Bond Market*,[4] Kate Jaquet examines the rapid development of the country's domestic bond market – now the world's third largest. Kate writes that the emergence of "well-functioning local currency bond markets with the help of an active and diverse investor base will strengthen and stabilize the Chinese economy and global financial system."

[1] www.seafarerfunds.com/funds/ogi/portfolio-review/2018/06/Q2
[2] www.seafarerfunds.com/commentary/chinas-tech-rush/
[3] www.seafarerfunds.com/commentary/one-belt-one-road-many-motives/
[4] www.seafarerfunds.com/commentary/the-evolution-of-chinas-bond-market/

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