How Will The World Of Emerging Market Investing Change In 2016?

BY NATHANIEL PARISH FLANNERY

2016 will be a challenging year for investors interested in emerging markets. China's economy continues to hiccup. Brazil and Venezuela are struggling. Meanwhile, well-managed economies such as Bolivia, Peru, Colombia, and Mexico will continue to face a challenging external environment. To get a sense of what investors should expect, I reached out to Robert Abad, a graduate of Columbia's School of International and Public Affairs (SIPA) who runs EM+BRACE, a boutique emerging markets advisory firm.

Nathaniel Parish Flannery: **How has the world of emerging market investing evolved over the last decade?**

Robert Abad: On many levels, emerging markets' evolution has defied all expectations. For example, if you look at the emerging market fixed income space a decade ago, the investable sovereign debt universe was dominated by Mexico, Brazil, and Russia. The emerging market corporate credit market was just coming out of its primordial stage, and emerging currency and local debt markets were mostly the domain of mostly opportunistic investors.

Fast-forward to 2016, and the changes in the emerging market investment universe and investor attitudes toward emerging markets have been staggering. What was once a small corner market frequented by Wall Street proprietary trading desks and dedicated emerging market hedge funds, has morphed into a global shopping mall trafficked by local pension funds in Latin America, insurance companies in the U.S. and Europe, sovereign wealth funds in the Middle East, and private bank and wealth management vehicles in Asia.

Given the pace of the market's transformation and investors' experience in navigating through so many boom and bust periods, an emerging market initiate might perceive that investing in this space has become easier over the years. This is incorrect. The explosive growth of emerging markets across all time zones, and technology's role in instantaneously transporting information and "emotion" across the world through major news outlets and social media channels has only served to reinforce the paradoxical nature of emerging market investing—too much information and choice leads to "analysis paralysis."

In the 1990s, investors had ample time to translate and process breaking news from different countries, analyze the structures of new transactions, and assign probabilities to potential market outcomes and risks. In the early 2000s, with the introduction of benchmarks that provide more visibility around the emerging market investable universe and useful metrics for portfolio construction, investors could manage emerging market within a systematic investment process or framework. Today, investors have less time to monitor the myriad risks of an emerging market universe that has more than doubled in size from a decade ago.

As a result of this trend, some professionals at larger institutions are shifting gears, either by moving to smaller firms or creating their own emerging market boutiques to focus exclusively on those areas of the market that they know best.

In an ironic twist, the evolutionary or "revolutionary" nature of emerging markets over the past decade combined with greater global connectivity has forced investors to take a step back and embrace the "wild west" investment style that prevailed in the market's earlier years.

Parish Flannery: **Looking ahead, what will the big challenges be for professionals working in the field?**

Abad: From an asset class perspective, emerging markets are undergoing a major rebalancing after a multi-year bull run. Heightened concerns around excessive central bank experimentation, the broad-based collapse of commodity prices, geopolitical risks, and a growing credibility gap in China, have dented investor confidence in "riskier" asset classes such as emerging markets. From a business perspective, financial institutions have been downsizing their emerging

Robert O. Abad, founder of EM+BRACE

IMAGE FROM SOURCE

markets teams and scaling back their geographic footprint as increased regulatory pressure and balance sheet restrictions have squeezed margin growth. Ongoing corruption and governance concerns in Brazil have also created a negative halo effect around primary and secondary market activity in Latin America—a critical profit center for any firm with a global emerging markets effort.

How long this malaise will last and what impact it will have at the individual level is difficult to say. The collateral damage will vary depending on a person's level of experience, firm and location. That said, the main challenge for any emerging markets professional—whether they work at a bank, asset manager or consulting firm—is recognizing and accepting that this global retrenchment will be a protracted affair. This means fighting through the insecurity and fear that come from a sharp and sudden change in the market environment, taking stock of where you are in life, and deciding whether it makes sense to ride out the market or consider a new career altogether. However, before you think about throwing in the towel, there are two silver linings to keep in mind.

First, the emerging markets industry is in the midst of a generational shift. Market veterans from the 1980s and 1990s who cut their teeth in various crises and spearheaded emerging markets efforts globally are dwindling in number as a result of attrition, retirement, or other causes. As "second generation" professionals move up to assume vacant senior-level roles, it should open up new opportunities and career pathways all the way down the value chain.

Second, China's slowdown and the sharp decline in oil prices may end up changing the landscape of emerging markets winners and losers and, in the process, turn financial markets upside down, but the world that flourishes thereafter will need professionals with valuable archival knowledge and experience. During past crises, financial institutions—in true knee jerk fashion—shut down whole trading desks, investment banking operations and local branches only to rebuild their emerging markets franchises and teams the moment they saw profit potential on the horizon.

Parish Flannery: What advice do you have for recent graduates looking to enter the field?

Abad: Nothing can really prepare you for a career in emerging markets. Irrespective of your background, education or prior work experience, the moment you step into this market, you're on a bullet train. Emerging markets are exciting and mentally stimulating, as they offers you a front row seat to watch a large part of the world evolve in real time, but make no mistake about it, the asset class is very demanding and the learning curve is steep and merciless.

To keep up, it helps to be a voracious reader. Aside from the daily content on mainstream news and popular financial websites, nourish your mind with books that contain maps and foreign languages rather than digesting more business-oriented books with formulas and pie charts. After the 2008 financial crisis, we're in a brand new paradigm; you need to think holistically to survive in your seat.

Before pursuing any "exciting" sounding emerging markets opportunity, do your homework. Will that firm which looks interesting on paper survive in this type of market? Is it the type of firm that allows analysts to travel to see first-hand what they're buying or selling? Does it advocate career development by embracing the importance of failure? Hedge your career risk early on by doing the proper due diligence.

The same applies to your prospective boss—it's important to build a mosaic of the person you'll be supporting through thick and thin. Therefore, put aside the smiles and niceties during the interview dance and do a deep dive on their background and reputation in the industry. The emerging markets community is very small and word quickly gets around on "who is who."

You may have some reservation about seeking emerging markets opportunities during this turbulent time. That's understandable. But at this early stage in your career, don't let fear of the unknown, or the doubters, or the tired rhetoric of "gloom and doom" you find in the papers get in the way of what could ultimately be a memorable journey. If you're willing to make the leap into emerging markets: be bold, strike and don't look back. F

Gross Domestic Product (GDP)

Based on Purchasing-Power-Parity (PPP) Valuation of Country GDP (U.S. Dollar in Billions)

YEAR	BAHRAIN	KUWAIT	KSA	OMAN	QATAR	U.A.E.
2010	49.726	218.951	1,217.783	127.908	220.845	468.491
2011	51.818	247.172	1,366.704	135.894	255.552	501.521
2012	54.667	271.022	1,466.825	146.375	272.959	547.648
2013	58.523	277.693	1,530.538	155.742	290.119	580.627
2014	62.166	282.638	1,609.628	162.967	306.616	617.138
2015	64.895	288.763	1,681.176	171.745	324.167	641.880
2016	**67.779**	**299.555**	**1,738.757**	**178.737**	**344.246**	**669.863**

Data Source: International Monetary Fund