Emerging Markets Are Not Created Equal

by Tom Lydon

Advisers and investors should not paint all developing economies with the same brush. As the economies shift, some countries will lead while others are left to deal with unforeseen problems. Consequently, advisers can pick and choose their emerging market exposure through country-specific ETFs.

When thinking about emerging markets, the BRICs (Brazil, Russia, India, and China) come to mind. However, after the plunge in energy prices, oil-producing countries like Russia and Brazil are falling out of favor. On the other hand, the new low-oil environment would benefit large importing countries. China, the world’s largest oil importer, has been filling its oil reserves in response to falling prices. Economists calculate that if oil prices remain below 30 percent of the $100 per barrel average for 2014, Chinese GDP could rise 1 percent this year.

Meanwhile, in India, the decline in oil prices has helped offset some of the costs after the government diminished oil subsidies. The country has also been struggling to maintain a strong rupee currency. The lower import bill would help save its foreign exchange, and easing oil prices could help relieve inflationary pressures that previously sapped Asia’s third-largest economy.

Due to the uneven growth outlook in the developing world, advisers can overweight specific countries instead of taking a broad emerging market position.

For instance, the PowerShares India Portfolio (PIN), iShares MSCI India ETF (INDA), and WisdomTree India Earnings Fund (EPI) provide broad exposure to India’s markets. PIN has a 0.82 percent expense ratio, INDA’s is 0.68 percent, and EPI charges 0.83 percent.

INDA and PIN follow cap-weighted indices, lean toward large-cap Indian equities, and include a heavy tilt toward the information technology sector. EPI does not follow a market-cap-weighted methodology but weights holdings based on earnings in their fiscal year prior to re-adjustments.

Advisers who want a more small-cap focus can also use ETFs to target the asset category, such as the Market Vectors India Small-Cap Index ETF (SCIF), EGShares India Small Cap ETF (SCIN), or iShares MSCI India Small-Cap ETF (SMIN). The average expense ratio for that trio is 0.84 percent.

For China exposure, advisers and investors used to be limited to ETFs that track Chinese companies on Hong Kong- or U.S.-listed exchanges, but investors can now directly access mainland markets through Chinese A-shares ETFs. The larger and older China ETFs, such as the iShares China Large-Cap ETF (FXI), SPDR S&P China ETF (GXC), and PowerShares Golden Dragon Halter USX China Portfolio (PGJ) track Chinese shares listed outside of China. FXI has a 0.74 percent expense ratio, GXC has a 0.59 percent expense ratio, and PGJ has a 0.70 percent expense ratio.

Potential investors should keep in mind that both FXI and GXC include large tilts toward the financial sector at 48.1 percent and 32.6 percent, respectively. On the other hand, PGJ is a more tech-based China play, with a 49.3 percent position in information technology companies.

Advisers interested in direct China exposure can look at China A-shares ETFs. The Deutsche X-trackers Harvest CSI 300 China A-Shares Fund (ASHR) and Market Vectors ChinaAMC A-Share ETF (PEK) both track the CSI 300 Index. The KraneShares Bosera MSCI China A ETF (KBA) tracks the MSCI China A Index, which tracks both Shanghai and Shenzhen stocks. And the PowerShares China A-Share Portfolio (CHNA) is an actively managed option that uses SGX FTSE China A50 Index futures contracts.

Alternatively, the First Trust ISE China Inde stock Fund (FNI), with an expense ratio of 0.60 percent, provides an easy way to gain exposure to China and India. This ETF takes the top 25 stocks from each country by liquidity and employs a stratified weighting methodology.

Although investors can easily track the broad emerging markets with a single fund option, it is important to acknowledge that the various economies will exhibit varying levels of growth. Consequently, advisers can employ country-specific ETFs to overweight potentially stronger growth opportunities.