

# money marketing

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# Blinded by China

Why advisers should not write off emerging markets



VALENTINA ROMEO

The pressure on emerging markets caused by the Chinese stockmarket crisis, on top of recent underperformance, is leading many investors to consider abandoning the once very attractive asset class.

Assets rushing out of emerging markets rose to \$1trn (£650bn) over the past year while, last week alone, following the worsening market data coming from China, there were \$10.5bn of outflows from the emerging market sector. This was the largest weekly outflow since January 2008, according to a Bank of America Merrill Lynch Global Research report.

The fallout exceeds the 2007-08 market falls, with total net capital outflows from the 19 largest emerging market economies reaching \$940.2bn in the 13 months to the end of July - almost double the \$480bn that left the region during the height of the financial crisis, according to data from NN Investment Partners.

JM Finn & Co associate Brian Tora says aside from the recent China market crashes, emerging markets have "lots of downward pressure" mainly caused by Brazil and Russia's recession and China growing at a much slower pace.

He says: "India seems to be the only country to keep growth upwards although the country's devel-

**China has a massive bearing on what goes around. It is still the epicentre of what is troubling people, however, fundamentals still look pretty strong as emerging markets are very diverse**

opment continues to be fragile."

Tora says China's stumbling blocks are its move from being a manufacturing and exporting country into a more consumer-led economy.

"The problem is that post-crisis China built up tremendous debt levels so this transition to a more consumer-led economy is proving very difficult.

"It is a brave man's buy at the moment. It is a situation that is not going to correct itself. You need more equilibrium within the region so at the moment it is better to remain cautious."

Axa Wealth head of investing Adrian Lowcock says the emerging market sector has been "out of favour"

following a period of strong performance, where emerging market equities became overvalued relative to their developed market peers.

He says: "As the recovery in the US gathered pace, a stronger dollar and expectations of rising interest rates have made some emerging markets less attractive to invest in."

"China also naturally weighs on the sector, with many countries dependent on the economic strength there. Emerging markets look set to remain out of favour for a while but longer term they will recover."

In recent months, the large outflows from emerging markets have been accompanied by some fund manager moves.

In July, Mark Mobius stepped back from the day-to-day management of the Templeton Emerging Markets Investment Trust after 26 years at its helm. Carlos Hardenberg, senior vice-president and managing director of the Templeton Emerging Markets Group, will take over in October.

In May, Jason Pidcock left the £4.4bn Newton Asian Income fund to run a new Asian Income strategy at Jupiter. Meanwhile, in November, Jupiter lost two veteran fund managers - Jupiter JGF China fund's Philip Ehrmann and Kathryn Langridge, manager of the Jupiter JGF New Europe fund and two UK-domiciled emerging Europe funds.

### Buying opportunities

It is not all doom and gloom for the sector, and investors should not be quick to dismiss it, as current conditions may provide a buying opportunity.

James de Bunsen, fund manager in Henderson's multi-asset team and manager of the Multi-Manager Income & Growth fund, says he sees value. He has topped up the fund's position in emerging markets, believing they will offer a better risk reward profile than current markets.

He says: "Clearly China has a massive bearing on what goes around."

## You need more equilibrium within the region so at the moment it is better to remain cautious

It is still the epicentre of what is troubling people, however, fundamentals still look pretty strong as emerging markets are a very diverse region."

In his fund he has added an index exposure as a "tactical trade" on emerging markets but he says it will be short-lived. "Brazil and Russia are in a dreadful place but although weakness persists, active managers can still find some good companies to bet on," he says.

Hermes head of emerging markets Gary Greenberg says the downward pressure could "lighten up" in the autumn when some of the economic stimulus created by the Chinese government should take effect. China should pick up in the next couple of months and improve next year, he says.

The People's Bank of China last week cut its main interest rate by 25 basis points to 4.6 per cent in an attempt to boost its economy after days of market turmoil.

The bank said the move to cut rates was intended to reduce "the social cost of financing to promote and support the sustainable and healthy developments of the real economy".

The cut, which will be effective this week, is the fifth by the Chinese central bank since November.

Greenberg says: "More importantly, what emerging markets need are new economic models. Some countries, such as China, Indonesia, Mexico and Poland, are more self-sufficient. They have less bureaucracy and are more open to investments than in the past."

However, he says some countries have not embarked on these transitions yet and some, namely China, are experiencing difficulties, meaning the future for the markets remains uncertain.

Greenberg adds: "We started the year with a 13.1 per cent overweight in China and began reducing the non-benchmark A-share portion of this in early June as valuations continued to climb."

"We cut our exposure by scaling back positions rather than exiting them completely as we still believe in the fundamentals of the stocks we own, and entered the turbulence of July with an overweight close to the current 2.6 per cent."

Aymeric Forest, Schroders' head of multi-asset investments in Europe and manager of the newly-launched Emerging Multi-Asset Income fund, says with volatility remaining high, investors should not just be diversified but also opt for dynamically managed strategies that focus on income generation. He says: "Investors should use flexible asset allocations both on a regional level and asset class exposure."

One such fund with a flexible approach is the Standard Life Global Emerging Markets Equity Unconstrained fund, which Lowcock recommends. It adopts Standard Life's "focus on change" philosophy, which is about how change, whether it is driven by the business or the industry it operates in, disrupts the market's ability to price the fundamentals of a company.

Lowcock says: "The Standard Life fund has significant exposure to IT which is frequently at the forefront of change as new technology transforms how industries operate. In addition, the fund is heavily exposed to China and India."

"Both countries are undergoing change across a lot of markets and more broadly at the political and economic level. This creates risks but also opportunities."

## ADVISER VIEW



**Dennis Hall**  
Managing director  
Yellowtail Financial  
Planning

Emerging markets are often quite small and illiquid and in times of global economic trouble they can rapidly lose a lot of value, not just through the underlying share prices, but also the wide spreads that emerging market funds can suffer. I don't dismiss the market, but it's not so attractive to me whether we're up or down. Even in our most adventurous portfolios we limit emerging market exposure to 10 per cent - but we have a buy and hold philosophy, we're not going to try and time the cycles. That said, I'd rather be buying after a slump than before - and it may be time to rebalance the emerging market exposure following the past few months' performance.



**Jonathan Davis**  
Managing director  
Jonathan Davis  
Wealth Management

It's amazing the investing world is about the only one when the prices collapse the shoppers run out of the store, whereas if Marks & Spencer cut prices by 50 per cent they'd be running into the store. Clearly emerging markets have had major problems in the short term and indeed for the past five years but there is really great value in emerging markets. China is moving from a manufacturing and exporting country to a consumption-based country and it is going through massive shocks to get there, but in the medium to long-term China is a fantastic investment opportunity, irrespective of short-term gyrations.

### EMERGING MARKET FUNDS WITH THE LARGEST OUTFLOWS

Fund Name	Size 3m ago (£m)	Size Now (£m)	Performance Effect on Size (£m)	Underlying approx. in/out (£m)
Aberdeen Emerging Markets Equity	1,990.25	1,688.82	-178.28	-123.16
Schroder Global Emerging Markets	848.95	690.8	-104.93	-53.22
Scottish Widows Emerging Markets	1,026.45	855.73	-145.57	-25.15
Newton Emerging Income	199.08	158.36	-17.06	-23.66
FP Henderson Rowe FTSE RAFI Emerging Markets	137.74	96.6	-21.84	-19.3
Lazard Emerging Markets	944.59	813.77	-112.82	-18
UBS Global Emerging Markets Equity	504.9	465	-34.14	-5.76
Henderson Inst Emerging Markets	40.04	28.79	-5.72	-5.53
SJP Global Emerging Markets	214.37	193.98	-15.57	-4.82
Investec Emerging Markets Equity	171.35	144.23	-23.67	-3.45
UBS Emerging Markets Equity Income	75.4	66.2	-5.9	-3.3
AXA Framlington Emerging Markets	133.95	118.26	-12.45	-3.24
BlackRock Emerging Markets	155.07	130.11	-21.78	-3.18
Legg Mason IF Martin Currie Emerging Markets	18	14.66	-2.22	-1.12

GLOBAL EMERGING MARKETS SECTOR OVER THE LAST 3 MONTHS TO 27 AUGUST

SOURCE: FE