Emerging markets: Three key insights for 2018

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The risks of emerging markets are different from developed markets. But they also present growth opportunities that are too big to ignore.

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Emerging markets sparked a lot of inquiries from advisors and investors in the past year. Those who weren't that familiar with emerging markets found them risky. And we heard the question, "What's wrong with limiting my investments to developed economies?"

But while emerging markets do present a different set of investment risks compared with developed markets, they also offer growth potential that established markets simply can't match. Here are three key insights to consider for 2018:

Keep an open mind about emerging markets. They're too big to ignore.

Emerging markets are about 40% of the global economy, and that's doubled in the past 25 years. Today, emerging markets are the largest economy in the world — bigger than the U.S., bigger than Japan and bigger than all of Europe. And emerging market economies are expected to grow faster than developed markets every year through 2021.[1]

Take advantage of the rapid growth potential of emerging economies.

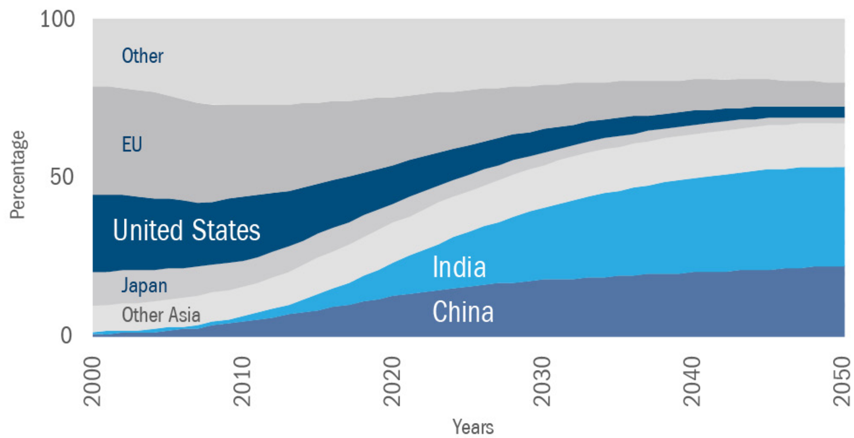
There are two factors that drive economic growth: population growth and productivity growth. And for both of those factors, trends favor emerging markets. The demographic story in emerging markets tells us that there's rapid population growth compared with developed markets. When it comes to productivity, it's not that we're doing anything wrong in developed markets; it's simply that we're already so productive. So, creating more output per worker in an advanced economy requires ongoing investment in the latest equipment and technology to help do the job faster and better. Boosting productivity in the emerging markets might be as simple as installing some lights so employees can work when it gets dark.

Count on the numbers. Consumption is a key theme for emerging markets investors.

In 2000, only about 4% of the world's population was middle class living in emerging markets. By 2030, that's expected to increase to 15%.[2] China is projected to overtake the U.S. as the largest middle class by 2020, and India is projected to pass the U.S. a year later.[3] It's not just the size of the middle class that's growing — it's also their discretionary income and spending. For investors, this translates to more opportunity for growth in consumer sector emerging market companies.

China and India are projected to be drivers of growing middle class

Global middle class consumption



Source: The OECD Development Center, published January 2010. Note: "Other Asia" reflects all Asian countries, excluding Japan, India and China, which are differentiated in the graph.

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Watch Ed Kerschner explain the case for investing in emerging markets:

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[1] International Monetary Fund as of 04/30/17.

[2] The OECD Development Center, published January 2010.

[3] Ibid.

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