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# CAMBRIDGE ASSOCIATES PERSPECTIVE: INSTITUTIONS SHOULD CONSIDER MAKING EMERGING MARKET EXPOSURE MORE LIKE DEVELOPED MARKET EXPOSURE

## *TYPICAL LONG-ONLY, "BRIC"-FOCUSED APPROACH TO EMERGING MARKETS MAY NO LONGER SERVE INVESTORS WELL: THERE ARE COMPELLING OPPORTUNITIES IN SMALLER MARKETS AND COMPANIES, AS WELL AS DIFFERENT ASSET CLASSES*

**BOSTON (May 17, 2011) --** Institutional and private investors who believe emerging markets offer the strongest long-term growth opportunities should **consider re-calibrating emerging market exposure to resemble developed market exposure**: Integrating smaller markets and companies and varied asset classes, such as debt, hedge funds and private investments, may be a prudent move, according to a new white paper from **Cambridge Associates**, the provider of independent investment advice and research to institutional investors and private clients.

"Most emerging market allocations currently consist largely of long-only strategies, overly concentrated in certain regions and countries, with exposure somewhat limited to multinationals like Gazprom and Samsung. In other words, most investors are essentially invested in giant companies largely based in the BRICs (Brazil, Russia, India and China). These investors may be missing opportunities with smaller companies that are more directly exposed to emerging market economies," said **Eric Winig**, a Managing Director at Cambridge Associates and coauthor of **"The Case for Diversified Emerging Markets Exposure."**

"Current approaches are fine as far as they go, but investors considering larger emerging market allocations – beyond 5% of their total portfolio – should look to generate equity-like returns and lower volatility over the long term and do more to exploit inherent inefficiencies in the emerging market universe. Rather than looking at pure, opportunistic beta, we now view emerging markets as deserving of a multi-asset class approach and a focus on both alpha and beta," added coauthor **Mary Jo Palermo**, a Managing Director at Cambridge Associates.

According to the paper, institutional and larger private investors should clearly understand the rationale for considering a larger allocation to emerging markets. Even though inherent risks remain, emerging economies are generally in much better fiscal shape than developed ones, with less debt (government, business and consumer), less financially onerous pension and health care obligations, and banking systems that are generally better capitalized. Meanwhile, the number of institutional-quality emerging markets managers has mushroomed. In crafting a strategy for building out the allocation over time, investors should consider a number of options, according to the paper, including…

- **Broadening equity exposures.** Most investors currently structure emerging markets allocations rather simply, accessing exposure through long-only equity products. Investing this way limits potential sources of return – in part by excluding many developing markets in North Africa, the Middle East and Asia Pacific region. Today a growing number of managers invest in niche plays or countries not heavily represented in the main emerging markets indices; these managers focus on under-researched micro-, small- and mid-cap equities, as well as frontier markets.

- **Adding emerging markets hedge funds.** In a diversified emerging markets portfolio, investors should use hedge funds in a similar way as they do in developed market allocations – to help provide equity-like returns over a full market cycle (as downside protection allows faster compounding, even with some sacrifice of upside participation). There are now more institutional-quality emerging market hedge fund manager choices than there were not long ago. In addition, the proliferation of newly public companies in emerging markets and the increase in M&A activity have increased the pond in which hedge fund managers fish, and thus the opportunities for good managers to add value.

- **Taking advantage of debt securities from emerging markets – ballast and growth.** The emerging markets debt market has gone from a distressed, equity-like market to a broad bond market similar to those of developed economies. It now includes a diverse mix of sovereign and corporate credit and liquid currency. It is large, liquid and has a broad geographic span – dominated by investment-grade and BB credits. Emerging markets debt can offer investors exposure to a broader swath of companies than is available through equity markets, and the manager universe in the emerging markets debt arena is expanding, with a number seeking to allocate capital across all emerging markets debt and currency markets.

- **Enhancing returns through private equity (and private equity-like) investments.** Emerging markets direct investments through illiquid vehicles can offer investors access to consumer growth and to sectors under-represented in the public markets. Since the number of institutional-quality emerging markets private equity funds is still somewhat limited, investors might look at certain other emerging markets funds that specialize in small, locally focused companies whose fortunes are tied more to organic emerging-market growth than developed-market exports.

"The bottom line is that investors who stick with long-only, large-cap emerging markets portfolios could conceivably be right on their overall pro-emerging markets thesis -- yet fail to capture much of the growth by virtue of holding mainly large multinationals that simply happen to be based in emerging markets," said Mr. Winig. "While there are certainly risks and potential problems, employing a more nuanced, complex manager structure may be the best route to getting the value of a 'true' emerging markets exposure," added Ms. Palermo.

Cambridge Associates holds a favorable view of long-term strategic prospects for emerging markets, despite the significant risks associated with this outlook. Nonetheless, investors who pursue an expanded emerging markets allocation should be cognizant that they are exposing themselves to the risk of underperformance and capital loss should emerging markets not perform as expected in the near term.

***To schedule a conversation with Eric Winig and/or Mary Jo Palermo or to request a detailed summary of the white paper, please contact Itay Engelman at Sommerfield Communications, Inc. at 212-255-8386 or Itay@sommerfield.com.***

**About Cambridge Associates**

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