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### MUTUAL FUNDS REPORT

# Surging Economies, In Search of Surging Stocks

By CONRAD DE AENLLE

**I**DEAS that come into vogue and fail to pan out may not be wrong, just early. Is “decoupling” one of those ideas, and has its time come at last?

Decoupling holds that rapid growth in emerging economies will support their stock markets during a recession in mature economies. The idea proved a disappointment in 2008, when markets in places like China, India and Brazil underperformed, even as their economies remained far healthier than those in more developed nations.

As stocks have plunged around the world, investors have been fearing a reprise of the desperate conditions of 2008. What also looks familiar is the resilience of emerging economies — and that is expected to persist, even if times get tougher. Whether those economies’ stock markets will join them this time and become a haven for investors is less clear.

The consensus among portfolio managers is that shares of companies tied to certain segments of emerging economies, those focused on domestic consumption, should provide some shelter from the next storm. Still, that protection is far from certain.

“The decoupling argument was probably as valid before as it is now if you think about economies,” said Jeffrey A. Urbina, co-manager of the William Blair Emerging Markets Growth fund. “The issue last time around is that capital markets were coupled. I’m not

sure that has changed.”

Fund performance during the third quarter indicated that, so far, it has not. The average stock fund in Morningstar’s categories for Latin America fell 25.1 percent, and for Asia (excluding Japan) it dropped 20.7 percent. The average American stock fund was down 16.2 percent, and the average fund focusing on Europe fell 23.7 percent.

The weakness in stocks in the developing world suggests that “the market isn’t yet buying that story” of decoupling, said Arjun Jayaraman, manager of the Causeway Emerging Markets fund. The reason, in his view, is that emerging economies, while less susceptible to recessions than mature ones, still depend on exports for much of their growth and so are not immune to global slowdowns.

But that is less true than it used to be, he and other managers say. As economies develop and populations become richer — World Bank figures show, for instance, that annual output per person in China has risen to more than \$7,500 from just under \$300 in the late 1970s — industries that cater to consumers, such as retailing, banking, real estate and tourism, become larger and potentially more profitable.

Capitalizing on that trend can be tricky, Mr. Jayaraman said. Investors often buy emerging markets in a single transaction, through a fund that closely follows a broad index. But most indexes offer

minimal exposure to the stocks that best exemplify the decoupling theme.

“Look at the large, multinational companies that are the biggest parts of indexes — technology companies like Samsung that are dependent on exports to the developed world, mining companies, energy companies,” he said. “Companies focusing on domestic consumers are still relatively small.” Investors, he said, should seek out funds “that focus on consumer plays or domestic plays in general rather than funds that track indexes.”

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*In a global  
downturn, will  
emerging-market  
stocks fare  
better?*

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The consumer plays that Mr. Jayaraman likes include Charoen Pokphand Foods, a Thai supplier of poultry and seafood; Astra International, an Indonesian car and motorcycle manufacturer; Vimpelcom, the Russian phone company; and Banco do Brasil, which he expects to benefit from expanding homeownership and mortgage borrowing in Brazil.

Mr. Urbina prefers retailers. Three favorites are Wal-Mart de México, Shoprite Holdings in

South Africa, and Sun Art Retail, a Hong Kong-listed company that operates hypermarkets in China.

Jonathan Brodsky, a portfolio manager at Advisory Research, cautions that there may be a price to pay for investing in some smaller companies in emerging markets, even if they otherwise are fine decoupling stories. Their stocks may be thinly traded, a byproduct of their size, and information about their operations and financial conditions may be limited.

One way around that is to invest in decoupling stocks listed on American markets. One that Mr. Brodsky mentioned is Banco Latinoamericano de Comercio, a Panamanian company that he said embodies “everything we think is good about emerging markets and has the pricing we think investors should be focusing on.”

The company conducts trade finance, so it is certainly no direct bet on domestic consumption, he concedes. But he expects its focus on lending to businesses involved in importing and exporting between Asia and South America to leave it substantially immune to sluggishness in mature economies.

Investing in stocks like these may be sensible — if investors behave sensibly. One reason that decoupling worked better for economies than markets in 2008 is that investors rejected anything that they perceived as risky, helping markets move in lock step. Mr. Urbina observes more of

the same today.

“Correlations among markets these days have gone up, not down,” he said. “I don’t know that it’s any better now than it was. Somehow we need to change the psychology of the capital markets.”

Risk aversion created an urge to bring money back from abroad in 2008, and there could be a repeat performance in the next downturn that could limit stock market decoupling, said Jerome Booth, research direc-

tor of the Ashmore Group, a fund manager specializing in emerging debt markets.

But a desire to keep assets close to home in hard times can cut both ways, Mr. Booth said. He highlighted International Monetary Fund data indicating that 94 percent of the several trillion dollars of reserves held by governments in the developing world were invested in the developed world — in Treasury bonds, for example, or similar foreign instruments —

at the end of the first quarter this year.

Owners of those reserves and the other newfound wealth in emerging economies can read financial headlines as well as anyone else, he noted, and they are just as wary of assuming excessive risk. That could support emerging-market assets, especially bonds, he said. He foresees governments with large reserves paring their exposure to the West and investing in one another.

“Emerging-market investors are getting more and more worried that they’re sitting there herdlike, not doing anything,” Mr. Booth said. Those who dismiss decoupling because they anticipate an exodus from emerging markets should be asking “how much money is going to go the other way,” he said. “What we’re going to see at one point is that people will start selling the developed world and start buying the emerging world.”

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