The Emerging Markets, Big Winners Or Losers?

Recently the emerging markets have become popular. In the parts of the world where communism was dominate, we are seeing it fade and democracy is starting to take hold. As this happens the world markets are expected to expand. This opens up the possibility of investing in regions where private ownership was unthinkable a decade ago. Those who do may reap the rewards of being first and incur the rates of return to match. This expectation is shown by the impressive returns of some of the special region funds in 1993 and 1994. Of the funds covered in our Fund Watch reports, the average one year return of the special region funds as of September 30, 1994, was 18.6%, while the Standard and Poors returned only 4.4%. In 1993 the results were even better. So, it appears that tremendous returns are out their just waiting for your investment dollar, or are they?

We have no doubt that there will be some fortunes made in this area, however we are also convinced there will be some staggering losses. Before you go gambling the house or your pension, we suggest you take a good look at the bigger picture.

First, there is the political climate. Many of these countries are experiencing democracy, or a version of it for the first time. They have gone from a life where the state controlled everything to one of choices where individuals are responsible for themselves. In this process they are experiencing major growing pains. We may have our concerns over Canada's political and economic stability, but few Canadians are worried about starving to death, being shot for their beliefs or that a civil war will break out. Our definition of stable differs from that of the majority of the world's population.

Then, there are the shares in these markets. Every now and then we hear about price related ratios that would normally indicate completely unrealistic prices. These are often accompanied by statements that the accounting rules are very loose, so you cannot really use these numbers, or that the circumstances are different in these countries. Is this supposed to give us a warm fussy feeling? It sounds somewhat similar to what they said about Dome Petroleum Limited in the late 1970's and early 80's. At the time it was one of the hottest, if not the hottest issue going, even though it was carrying unthinkable amounts of debt. Yet no one seemed concerned, because it was different, so different that some employees mortgaged their homes and borrowed everything they could to buy more stock. When interest rates skyrocketed and oil prices did not meet expectations, the whole thing fell apart, including the personal lives of some of the investors.

Finally, there is the amount of money being invested in this area. The Special Regions portion of our Fund Watch reports includes funds totaling approximately $13 billion. Of these funds only 10 totaling approximately $2 billion are over 5 years old. This is nearly all new money, and it equals approximately 9 percent of the $149 billion invested in the funds that we cover. Clearly this is a very large amount of money invested over a short period of time. Also, this is only what Canadians are investing, just think of the impact of the really big countries. What will happen when expectations are not met or things go wrong.

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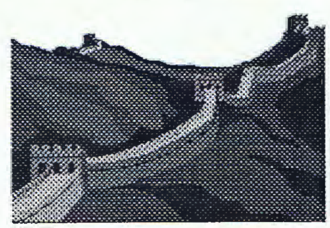

As the majority of the world's population become customers many fortunes will be made. But beware, the politics can be deadly.

If this has made you nervous, that's good because aggressive investing needs to be accompanied by a little fear, it helps to keep us honest. So let's put things back in perspective. As we said, there will be big winners and losers in this area. Also, we believe that the potential of these emerging markets is too big to ignore. So, in one form or another they may have a place in your portfolio. However, investments in emerging market funds should only be considered as the very speculative part of your portfolio, and it should only be money that you can afford to lose.