

Exploring Emerging Markets

Investing in emerging markets can provide substantial benefits—but it also poses certain risks. The following questions can help you understand how you might be able to take advantage of the opportunities that emerging markets offer.

Q. What is an emerging-market country?

A. Emerging-market countries have economies and financial systems that are significantly less developed than those in industrialized nations such as the U.S., Germany and Japan. Most emerging markets are in Latin America, Eastern Europe or continental Asia.

Q. Why invest in emerging markets?

A. Emerging-market countries can offer growth potential to investors because their economies often grow more quickly than the economies of developed countries like the U.S., providing numerous opportunities for corporations to boost profits, which can help lift stock prices. For example, developing nations contract out to various types of firms to build much of the infrastructure—including roads, factories, airports, computer networks and so on. What's more, rapidly expanding economies may create new consumer classes, as what recently happened in China. These new consumers can create demand for a wide range of items, from cars to computers.

Q. But aren't emerging markets risky?

A. Absolutely. Developing countries may have unstable governments or shaky financial systems, which can lead to stock market losses. Emerging markets also may be highly dependent on one or two industries; any downturn could throw the country's economy and market into turmoil. In particular, many emerging economies are dominated by companies that export natural resources such as metals. As a result, the markets in these countries are heavily influenced by global demand for natural resources—so when demand wanes, the markets can fall.

Q. Given all that risk, does it still make sense to invest in emerging markets?

A. Depending on your investing objectives—yes, but with caution. Different factors can affect emerging-market stocks compared with U.S. stocks, including political developments and local and regional economic growth. As a result, emerging markets often move in very different patterns than stocks in the U.S. or other developed markets, so a rally in emerging markets may help offset a downturn in other stock markets around the world, and vice-versa. Therefore, keeping a small portion of your equities holdings allocated to emerging-market stocks—which your financial advisor can help you establish—may help stabilize your portfolio over time.