

## Funds For The Brave - RIA Pro



The ongoing currency crisis in Turkey means emerging markets stocks and bonds have suddenly become dangerous. Addressing EM bonds, [Nomi Prins](#) thinks EM countries have benefited from an avalanche of borrowed dollars that will soon become difficult to pay back as the dollar appreciates from higher interest rates. And one missed payment, Prins argues, could set off a chain reaction of defaults. Speaking of emerging markets stocks, Ben Inker of Boston-based Grantham, Mayo, van Otterloo (GMO) argues in the firm's most recent quarterly letter that, despite their currency problems, they continue to offer the best 10-year return prospects compared to other stock markets in the world by a large margin. Their recent volatility owes more to their correlation to movements in their currencies. (U.S. investors also take on foreign currency exposure unless they invest through a fund that uses currency hedges.) Momentum is not on their side now, but over the long term, valuation is much more predictive of returns for emerging (markets stocks) than momentum is, says Inker. Things could get worse before they get better for emerging markets securities. And if the typical emerging markets bear market is an indication, things could get much worse. But for those who want to start wading in or who just want to be ready when they think the time is right, we'll lay out some EM stock ETFs to consider: In the stock category the iShares

MSCI Emerging Markets ETF (EEM) is a way to capture the emerging markets index. Its expense ratio is 0.69% or \$69 for every \$10,000 invested per year. Chinese stocks soak up a full 30% of the fund's assets. South Korea, Taiwan, and India together absorb another 35% of the fund's assets. South Africa and Brazil come in at 6% each. The fund isn't currency-hedged, and it is down more than 9% for the year through August 20<sup>th</sup>. iShares offers a slew of country-specific and currency-hedged options too. But most investors should be wary of getting country-specific exposure in emerging markets. As for currency hedged funds, the dollar could appreciate more, but it's already had quite a run. Another interesting option is the iShares Emerging Markets Dividend ETF (DVYE). The fund's emphasis on dividends gives it a 5.33% yield currently, but it also causes some deviations from the plain capitalization-weighted emerging markets index. Taiwan occupies 30% of this fund's assets instead of China, which comes in at around 9%. Russia and Thailand also have elevated exposure compared to the plain capitalization weighted index at 15% and 9%, respectively. Both GMO and Newport Beach, Calif.-based Research Affiliates have argued that not only are emerging markets stocks cheap, but the value part of emerging markets is exceptionally cheap. A dividend fund often captures more of the value (low price/earnings and price/book value) stocks. The fund is down more than 4% for the year through August 20<sup>th</sup>. Similarly, the Invesco FTSE RAFI Emerging Markets ETF (PXH) can help an investor capture some of those cheaper stocks. This fund gains exposure to 90% of the holdings of an index comprised of companies ranked on book value, cash flow, sales, and dividends. This "fundamental" methodology was devised by Rob Arnott of Research Affiliates. The methodology isn't a pure value strategy the way simply buying the lowest price/book value or price/earnings stocks might be, but it can capture some of the value factor. The fund is down around 6% for the year through August 20<sup>th</sup>. A third ETF to consider is the WisdomTree Emerging Markets SmallCap Dividend Fund (DGS). This fund captures the return of small cap emerging markets stocks that pay dividends, as its name suggests. It currently yields over 3%. Its biggest country weightings are Taiwan at 27%, China at 16%, South Africa at 10%, South Korea at 8%, and Thailand at 7%. The fund is down 10% for the year through August 20<sup>th</sup> so it has exhibited more volatility as one might expect from a small cap fund. Even if you don't have the courage to take the plunge now, or think Inker's analysis isn't cogent, at some point you might decide it's time to get exposure to the developing part of the world. When that time comes, you'll have a group of funds from which to choose.

Fund	Ticker	YTD through Aug. 20
iShares MSCI Emerging Mkts ETF	EEM	-9.42%
iShares Emerging Markets Dividend ETF	DVYE	-4.49%
Invesco FTSE RAFI Emerging Markets ETF	PXH	-6.03%
WisdomTree Emerging Markets SmallCap Dividend Fund	DGS	-10.12%