

# Long-term prospects in emerging global markets remain strong, CFA conference attendees told

Best-performing asset class faces increased risks, uncertainty, political volatility and taxation complications

By Richard Chu

Emerging markets will increasingly become the drivers of global economic growth and investment potential in the coming decades, despite their increased risks and volatility, financial analysts were told at a CFA Vancouver event last week.

Jonathan Passmore, senior vice-president and international equities portfolio manager at GE Asset Management, said the financial crisis, which continues to affect the developed world, has not halted the comparatively rapid growth in developing economies.

"Two-thirds of global growth this year, according to the IMF [International Monetary Fund] will come from emerging markets. They're making an enormous contribution."

Passmore added that, despite the Asian and Russian crises in 1997 and 1998 and the global financial crisis in 2008 and 2009, the combined economies of the BRIC countries (Brazil, Russia, India and China) have not fallen below 5% real GDP growth since 1992.

By comparison, GDP growth in the developed world has remained below its peak of around 4% in 2000. It declined in 2009 before being boosted by stimulus funds from the world's most-developed countries.

Emerging market growth has shown positive investment results in the past decade. According to a Towers Perrin report released last week, emerging markets have been among the best-performing asset classes over the past five and 10 years, even outpacing commodities and global investment-grade credit.

Emerging markets, however, are not without risk or volatility. For example, Passmore noted that investors might be more cautious this year given the political uncertainty in more than 40 developing countries, including Brazil, that are facing elections in 2010.

But electoral and taxation uncertainties in the developed world will also chill the investment climate. That was illustrated last week by a proposed mining tax in Australia, which followed



Jonathan Passmore, senior vice-president and international equities portfolio manager, GE Asset Management: massive infrastructure spending a key investment opportunity in emerging markets like China, India, Brazil and Russia

ongoing concerns over the solvency of Greece, Portugal and Spain that have weighed heavily on global equity markets.

While uncertainty will continue to affect markets, it likely won't undermine economic growth in emerging economies. The HSBC trade confidence index released last week found that importers and exporters in Asia, particularly those in India and Southeast Asia, are the most confident about securing financing to support new orders in the next six months. The index assesses input from more than 5,000 small and medium-sized businesses in 17 countries.

The report said that intra-regional trade will underpin global trade in the next six months and noted that Southeast Asian trade is expected to grow following the January 1, 2010, institution of the free trade agreement between China and the 10-member Association

of Southeast Asian Nations (ASEAN).

Passmore noted that economic growth in emerging markets will also be fuelled by increasing urbanization and massive population growth projected over the next 20 to 40 years in developing countries. He said infrastructure spending in emerging markets required for that growth is estimated to more than double over the next seven years to about \$3.5 trillion in 2017 from over \$1.5 trillion in 2010.

"That's an absolutely massive amount of money and with that much investment needed in emerging markets that's an investment opportunity."

The bulk of that investment will be in Asia and specifically in China. While China's central government

## Equities in developed markets losing ground

Percentage index returns to March 31, 2009

	1 year	5 years	10 years
Developed market equities	-19.8%	1.9%	-0.6%
Emerging market equities	-26.6%	11.8%	10.0%
Emerging market debt	-8.1%	6.4%	11.6%
Commodities	-25.8%	10.4%	10.1%
High-yield debt	11.4%	4.8%	3.7%
Global investment-grade credit	31.8%	9.2%	6.5%

SOURCE: DATASTREAM, TOWERS WATSON

invested more than US\$586 billion in infrastructure stimulus spending during the financial crisis to offset declines in exports, it will need to continue to rapidly expand its economy to mitigate rising unemployment and the social unrest it can cause.

Increasing private consumption will also provide investment opportunities

as the use of scooters, cell-phones and other modern conveniences increases.

"This is as much about trends as much as it is about absolute values," Passmore said. "Any uptick in consumption can be valuable and extremely sustainable because the penetration rates, for cellphones, for example, remain very, very low." ■

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## MONEY BUSINESS

### HARRY JAAKO

*Trailing in the innovation race means faltering productivity and a dimmer future*

Former Bank of Canada Governor David Dodge said recently that our productivity sucks.

B.C. and Finland are similar in many ways. However, when it comes to funding an innovation to improve productivity, Finland is making the much bigger investment.

B.C.'s population is 4.4 million with a GDP of \$200 billion; Finland's is 5.2 million with a GDP of \$270 billion. Per capita, B.C.'s GDP is \$45,450; Finland's is \$51,920. B.C.'s major centre is sophisticated Vancouver with a metro population of 2.2 million; sophisticated Metro Helsinki has 1.4 million.

Both countries have resource-based roots, fabulous outdoor lifestyles, a deep attachment to their forests, stunning coastlines, large ferry fleets and similar life-expectancy rates.

Both share a desire to embrace technological change and diversify their economy to keep raising productivity and their standard of living.

However, Finland is much more committed to investing the resources needed to make it happen. Finland has an innovation strategy

that is working. It has made high-speed Internet access a legal right for every citizen. Finland walks the talk. We don't.

In 2008, Finland invested 3.7% of GDP, or \$10 billion, in innovation. Of this, \$7.5 billion was private. Finland's Nokia is Europe's top R&D investor, but most of Finland's companies invest in R&D. Fifty-one per cent of all enterprises had innovation activity from 2004 to 2006; 33% had product innovations, 36% process innovations and 30% had innovation projects. Fifty-five per cent of manufacturers had innovation, especially chemical manufacturers, where 77% of enterprises practised it. Finland's government invested \$2.5 billion. This would be akin to B.C. investing \$8.5 billion in total or Canada investing \$63 billion annually in innovation.

The difference is staggering.

Canada invests just 1.9% of its GDP in innovation. According to the Organisation for Economic Co-operation and Development, that ranks it 24th out of 26 developed countries.

Finland and other countries with similar innovation philosophies, like South Korea, Japan or Sweden, consider this investment a vital and permanent public-policy commitment.

B.C. and Canada, on the other hand, subscribe to a "market theory" view of investment: innovation investment is cyclical and when innovation funding is out of favour, accept that you have long periods without investment and simply wait for investment interest to eventually return. Venture investment in Canada today is at its lowest level in 15 years and, according to Dodge, our productivity growth is pathetic.

From a public-policy perspective, tolerating a market view of innovation funding cycles is incredibly damaging. A truly integrated innovation-driven economy that builds working partnerships between government, academia and industry can't be built on investment swings that go up and down like the tides. A society that is committed to reaping the long-term productivity benefits of innovation must find a way to insulate itself from these

cycles. Many components of these partnerships, such as advanced education institutions, just can't be cranked up and down to suit market whims.

In B.C., Iain Black's Small Business, Technology and Economic Development Ministry is doing an economic assessment

## Finland walks the talk. We don't

of such innovation investment programs as the Small Business Venture Capital Act, which in various forms has been around since the 1980s and has funded thousands of B.C.'s innovation startups. The program offers a public-private risk-sharing model to private investors, whereby Victoria provides a 30% tax credit toward private-sector investments.

One hopes that the assessment's scope will recognize the importance of innovation investment in this province.

It's critical to understand the direct economic returns from the individual investments made under the program. But on a macro scale,

we also have to look at its impact on the labour-market growth in B.C. for young people and the extent to which we commercialize university-based research in B.C., which is fully funded by the public. How about productivity improvement in health care?

The study could highlight growing income tax revenue that results from higher-income innovation jobs – being created at a faster rate than other jobs in B.C. – and the impact of the "greener" lives lived by young innovators who live and work downtown and walk, cycle or transit to work or work from home.

The study might even conclude that like Finland, B.C. really must find a way to invest something like \$8.5 billion per year in innovation to increase its productivity and raise the standard of living for its future generations.

Otherwise, according to Dodge, other regions that make larger innovation investments will increasingly become more prosperous, and we will have to work ever more hours and retire later and later. ■

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