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Minimizing global investment risk

Consider looking at developed-markets companies that offer emerging-markets exposure

By David Marcus
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Investment advisers and their clients once again have turned to emerging markets as they scour the globe chasing higher returns.

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Emerging-markets exchange-traded funds took in $1.5 billion in October, TrimTabs Investment Research Inc. reported. According to published reports, that was the most in six months and rivaled the average $1.4 billion of monthly inflows during the two strongly bullish years that followed the March 2009 low.

To be sure, weak economies, high unemployment and unsustainable debt burdens are weighing down financial markets in much of the developed world. At the same time, many developing countries have vibrant, dynamic economies and young, innovative companies whose high growth potential investors find irresistible.

One way to minimize risk is to invest in international companies domiciled in developed markets that offer exposure to emerging markets. This back-door approach offers several tangible advantages for investors.

The first is value.

By investing in, for example, a European corporation doing business in emerging markets through local companies in which it holds ownership stakes, investors avoid paying what are generally much higher multiples for a direct investment in those developing countries. At the

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same time, investors still profit from the rising valuations of those companies, which accrue to the bottom line of the European stakeholder.

The second idea is corporate governance.

The emerging-markets investment environment is quite different from what investors are accustomed to in well-established global markets. Standards vary widely on a whole host of issues, including shareholder rights, accounting principles and transparency.

Although companies in established markets have long track records in dealing with and reacting to the vagaries of the capital markets, entities in emerging markets, by definition, have a limited equity culture and capital markets history. Investing in a company based in a developed market provides investors with the comforts of transparency and corporate governance that they have come to expect.

The third point is volatility.

This year notwithstanding, companies in developed markets typically exhibit lower volatility than those in emerging markets. Aside from the usual economy-related culprits, political risk is an unavoidable fact of life in many emerging markets, and a volatility driver. Events this year in Africa, Asia and the Middle East underscore this reality.

That isn't to say that investors in developed-market companies with emerging-markets exposure won't be affected negatively by regional political risk and other factors. However, investors will have a buffer that simply doesn't exist with a direct investment in a particular country.

Investors also can be assured that the developed-market company will be doing all it can to reduce exposure and limit the damage to its stock price.

WHAT TO LOOK FOR

Ideally, investors seeking emerging-markets opportunities should look for an established company in a developed market that offers broad exposure to emerging markets and other global markets.

One such company is the French conglomerate Bolloré SA. Founded in 1822, this highly diversified company is listed on the Paris stock exchange and majority-owned by the family that started it.

In addition to its operations in France, across Europe and in the United States, Bolloré is involved in a variety of businesses in emerging markets. For example, it owns the largest logistics company in Africa.

The company transports agricultural commodities such as cocoa to ports for shipment across the world and operates container terminals across the African continent. It is also a major shareholder in a Cameroon-based company that is one of the biggest independent rubber and palm oil plantation owners in the world.

In Asia's emerging markets, Bolloré has industrial and plantation operations in Cambodia, Indonesia and Malaysia, as well as a presence in 17 other countries, including China and India.

Although emerging markets may offer many enticing opportunities, investors must realize that there is more than one way to participate in what these markets have to offer. Start by looking past where a company is headquartered and see what doors it can unlock across the globe.

As value investors, we don't believe in charging into emerging markets; sneaking in is the best way to make money.

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David Marcus is chief executive and chief investment officer of Evermore Global Advisors LLC.

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