

Managing Funding and Investments Forum 2008

**The Case for Emerging Markets:
Issues and Opportunities**

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A presentation by
Nomura Asset Management
U.K. Limited

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Agenda

- 🌐 **What is the strategic case for investment in emerging markets?**
- 🌐 **Where do they fit within pension funds?**
- 🌐 **What is the best way to gain exposure?**

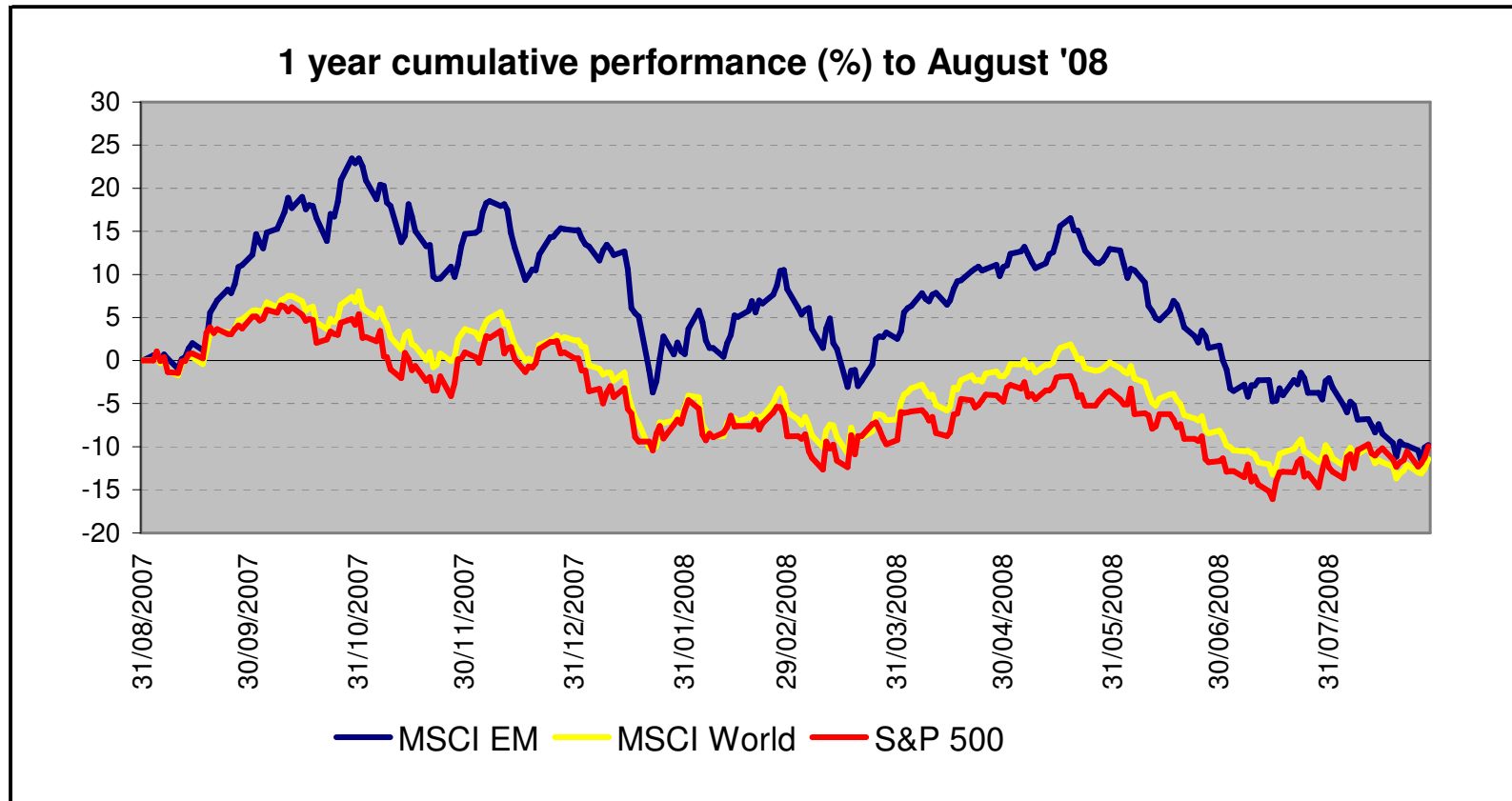
American Family with Possessions



Mongolian Family with Possessions

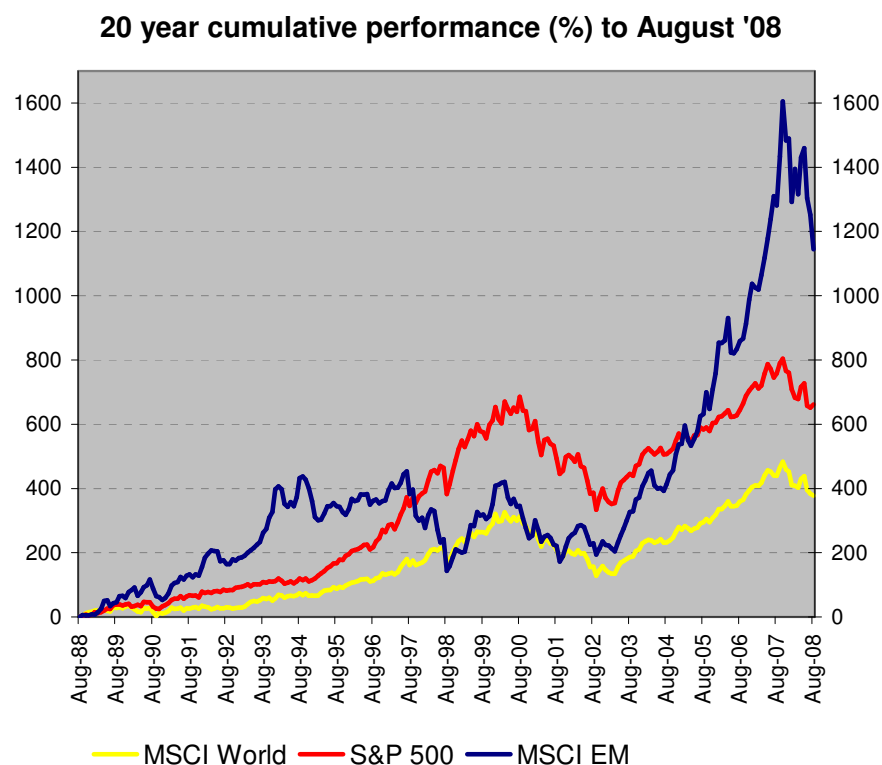
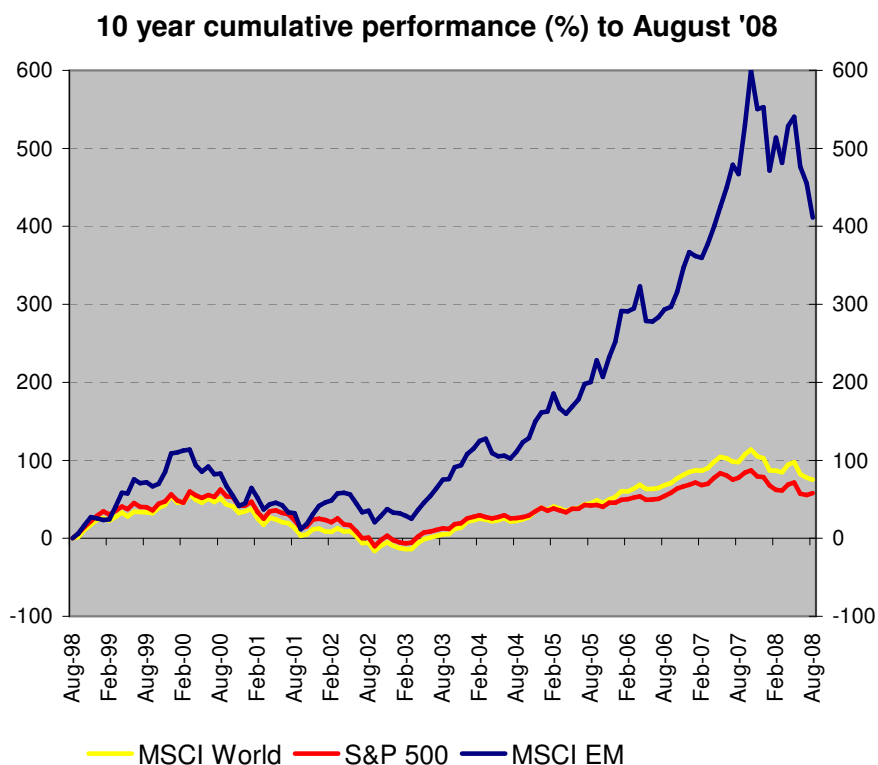


Emerging Market Performance: 1 Year to Aug '08 (US\$)



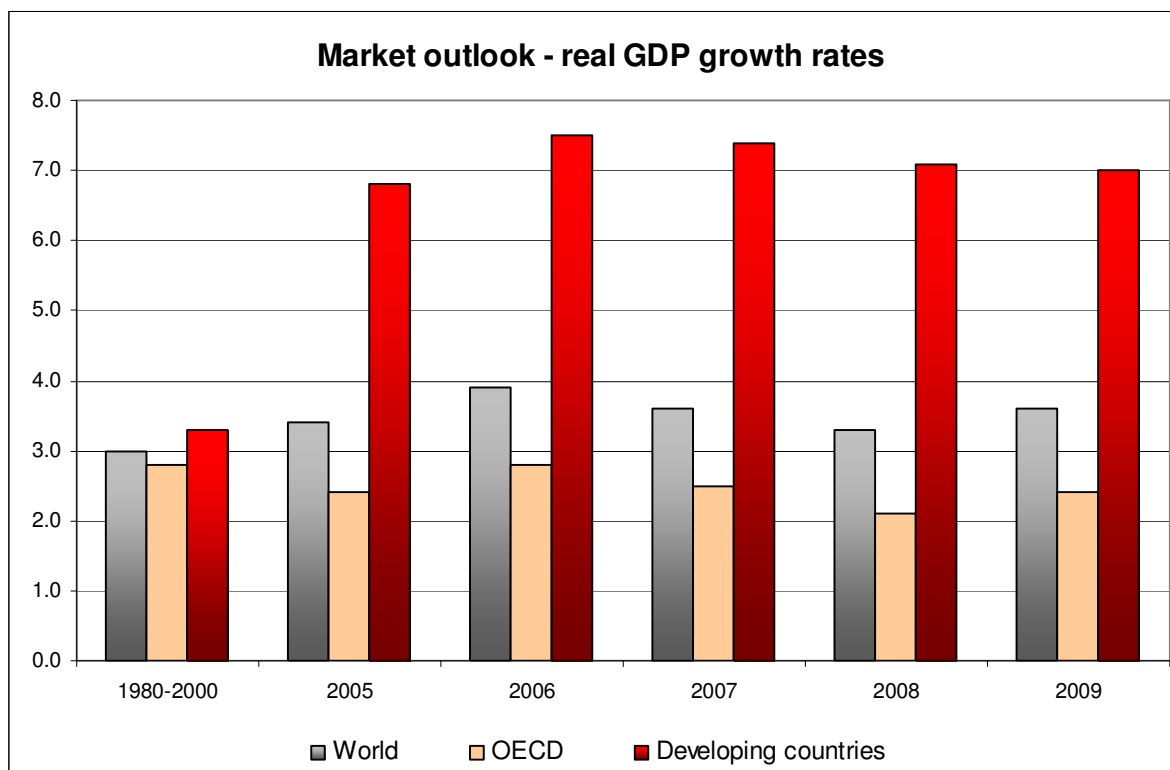
Source: NAM, Datastream

Emerging Market Performance Over 10 and 20 Years (US\$)



Source: NAM, Datastream

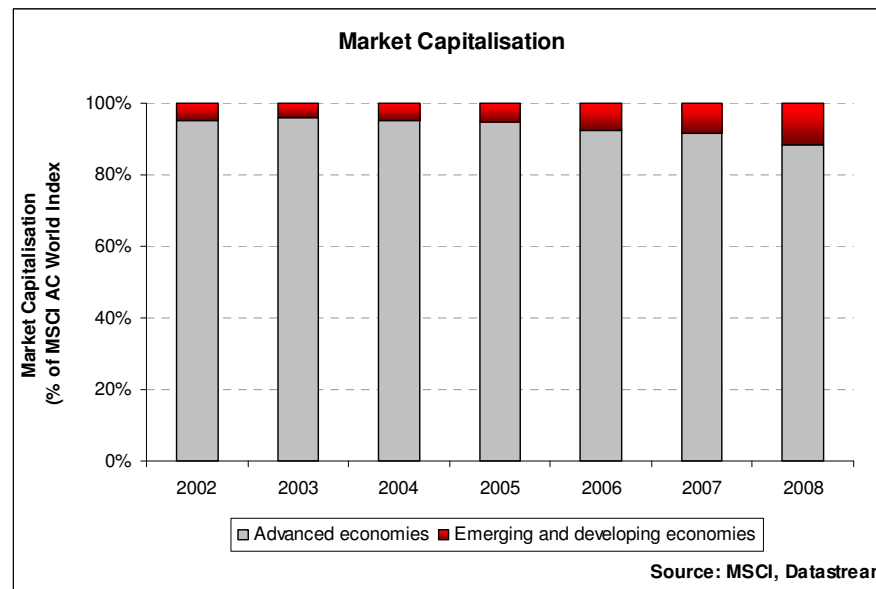
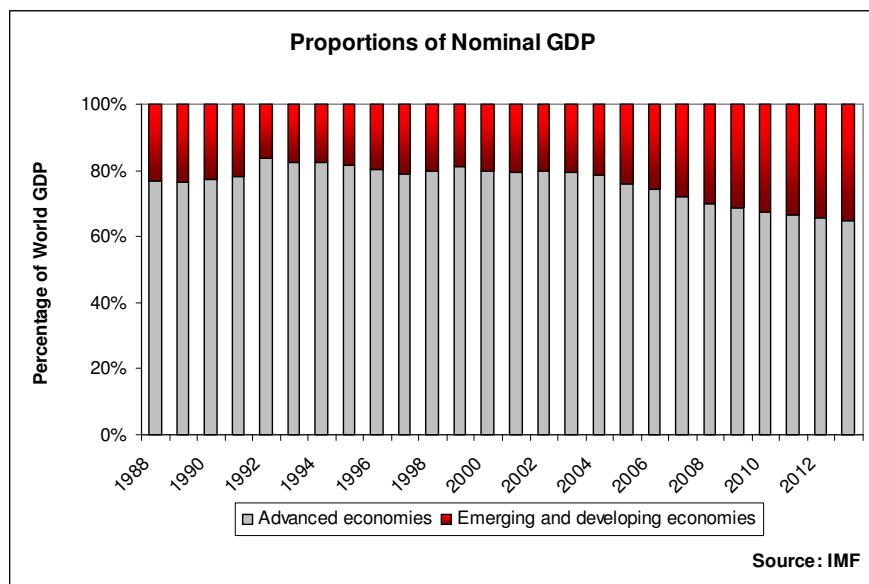
Why invest: High Growth Rates



Source: Global Economic Prospects 2008, The World bank 2008

- **Growth rates consistently ahead of advanced economies**
- **Emerging economies partly insulated from forecast dip in Developed world**

Under capitalised markets



Source: IMF World Economic Outlook Database April 2008, IMF 2008

🌐 Compare proportions of GDP and proportions of market capitalisation

- Emerging market capitalisation well below developed market levels
- Rising trend established, but a long way to go
- Emerging markets 25% of GDP, but only 12.5% of markets

Under capitalised markets

Figure 3. Japanese global market capitalisation and GDP as a % of global

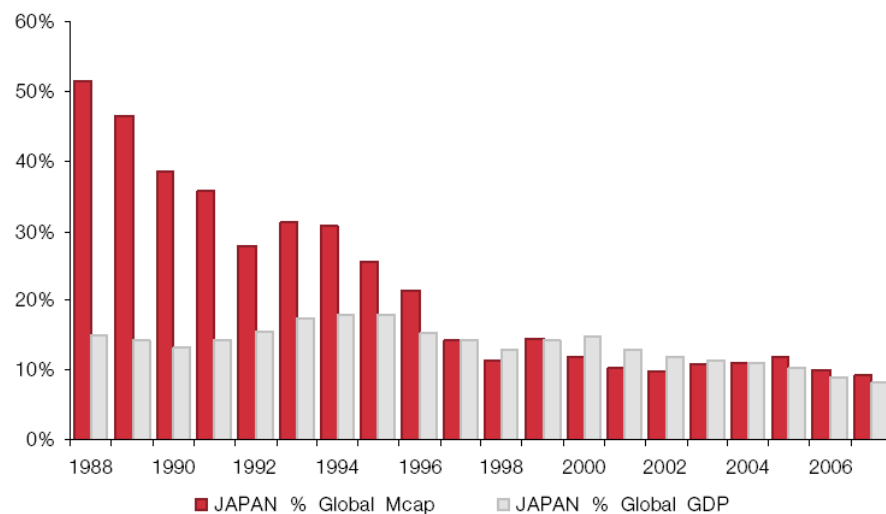
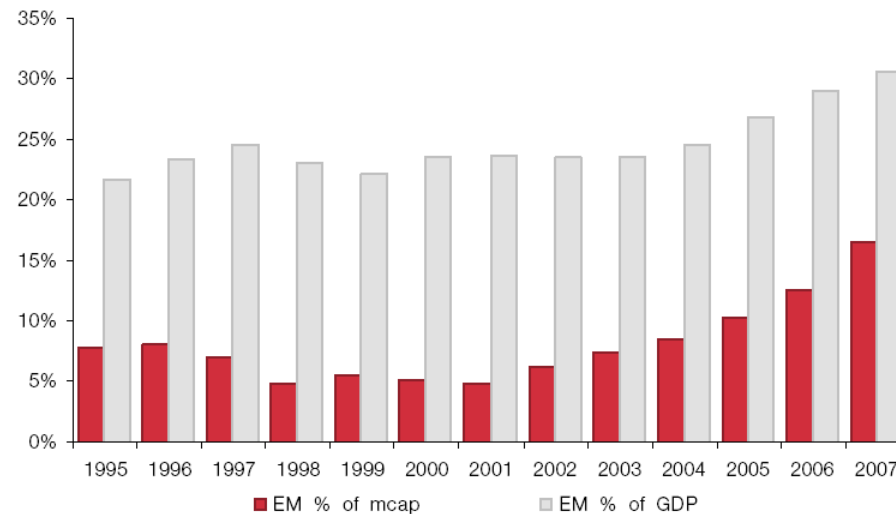


Figure 2. Emerging market GDP and equity capitalisation - as % of global

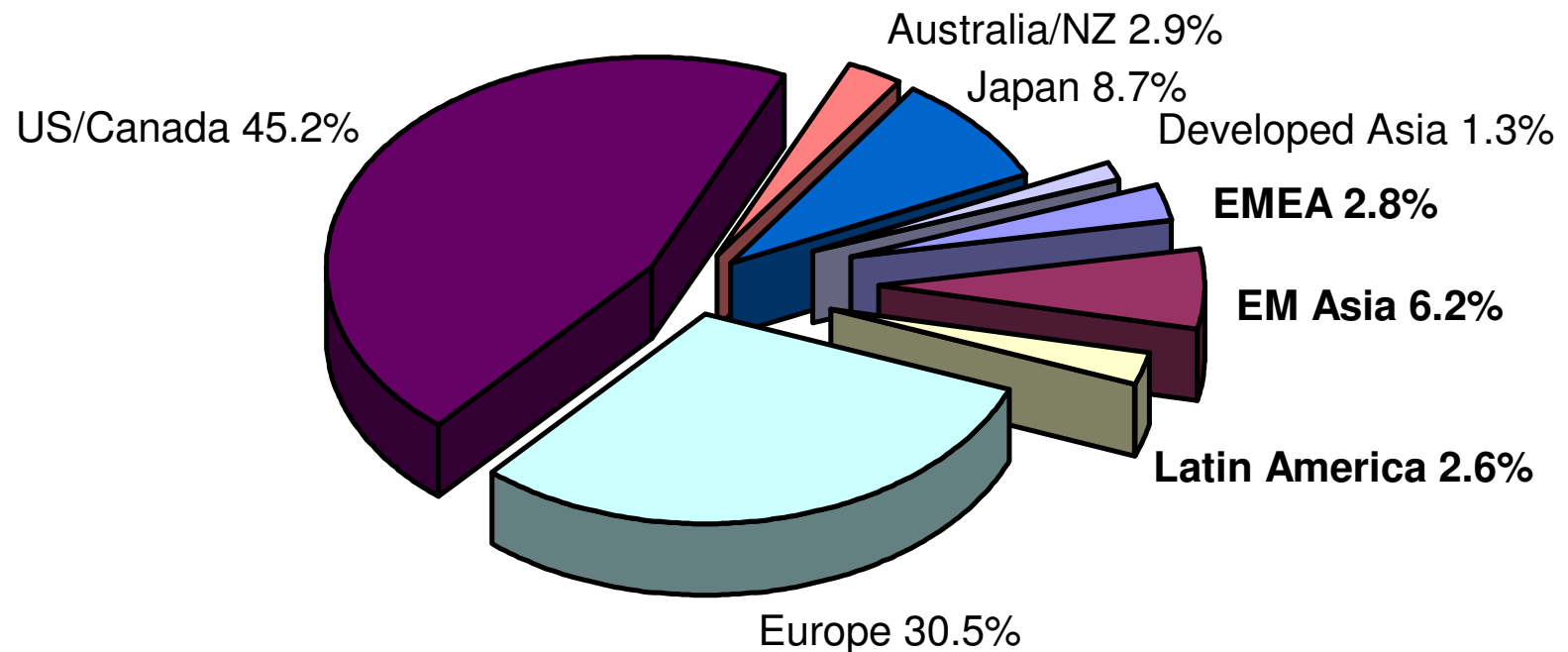


Source: IMF, Datastream, Nomura January 2008

Source: IMF, datastream

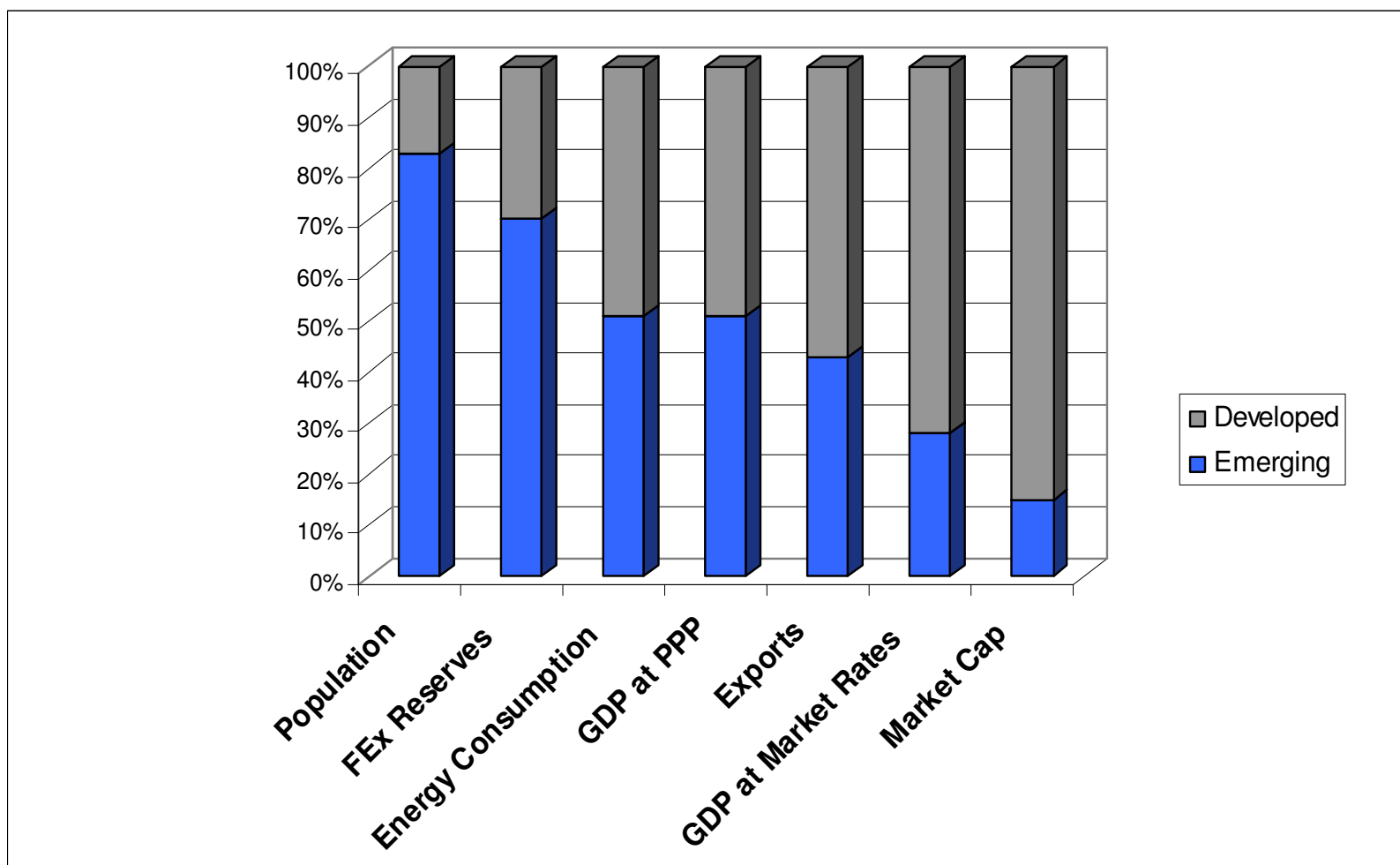
- 🌐 **Japan's market capitalisation v's GDP chart highlights the bubble in late 80's**
- 🌐 **Emerging markets under represented, but trend of increasing market cap evident**

Do Emerging Markets Matter?



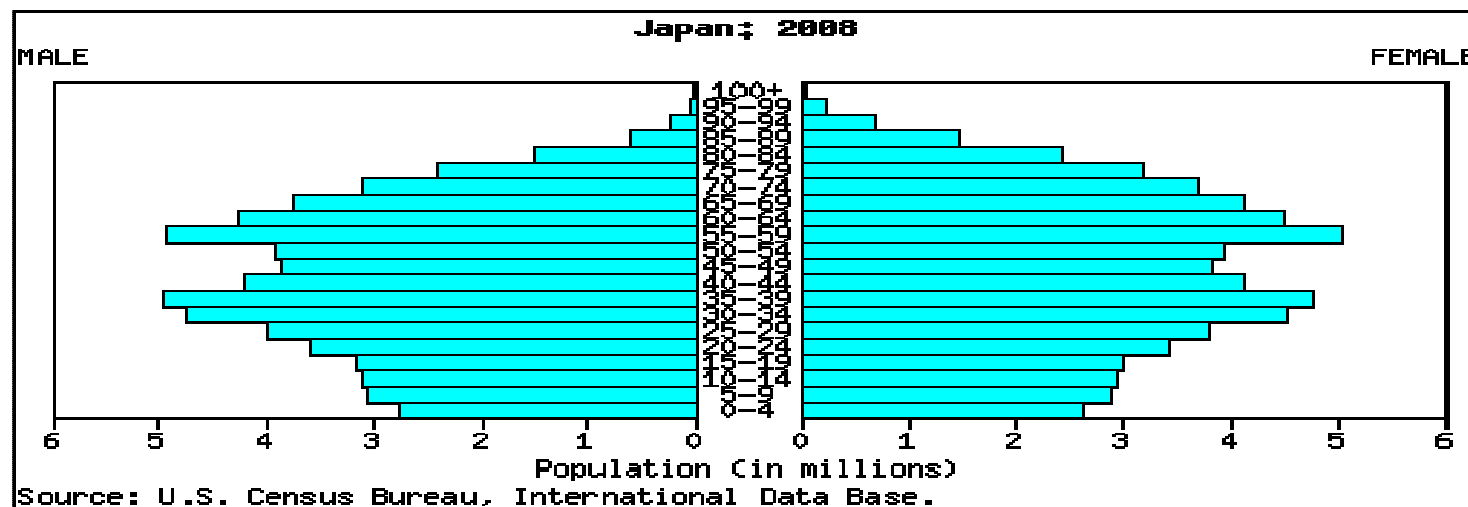
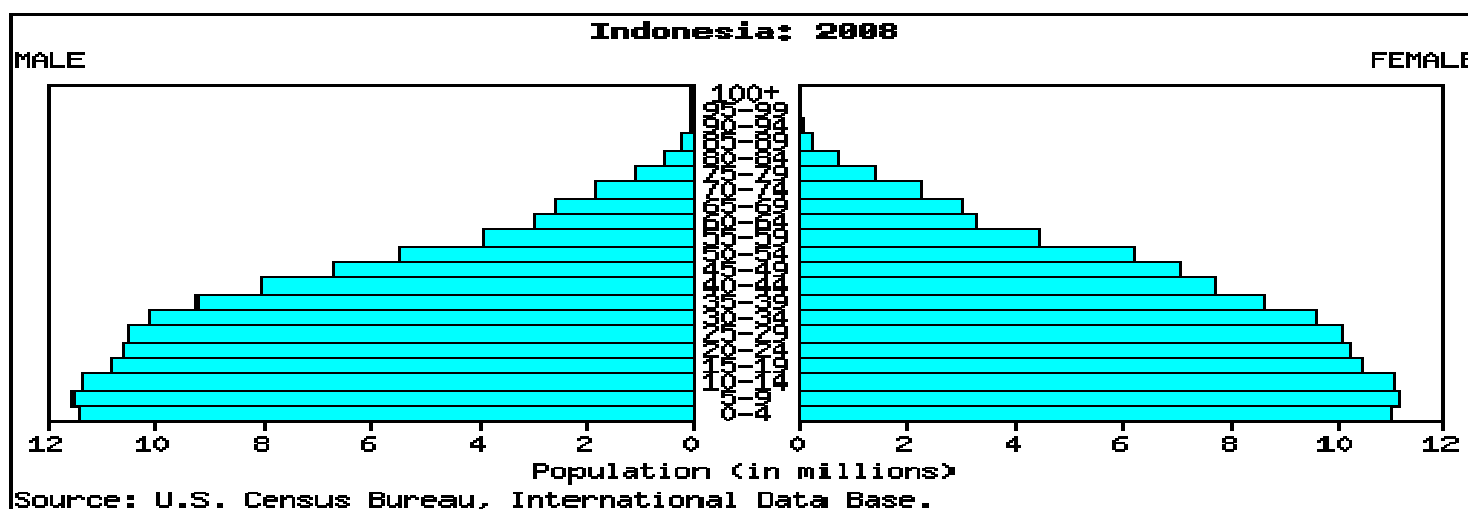
Source: MSCI Red Book as of March 2008

Why Do Emerging Markets Matter?



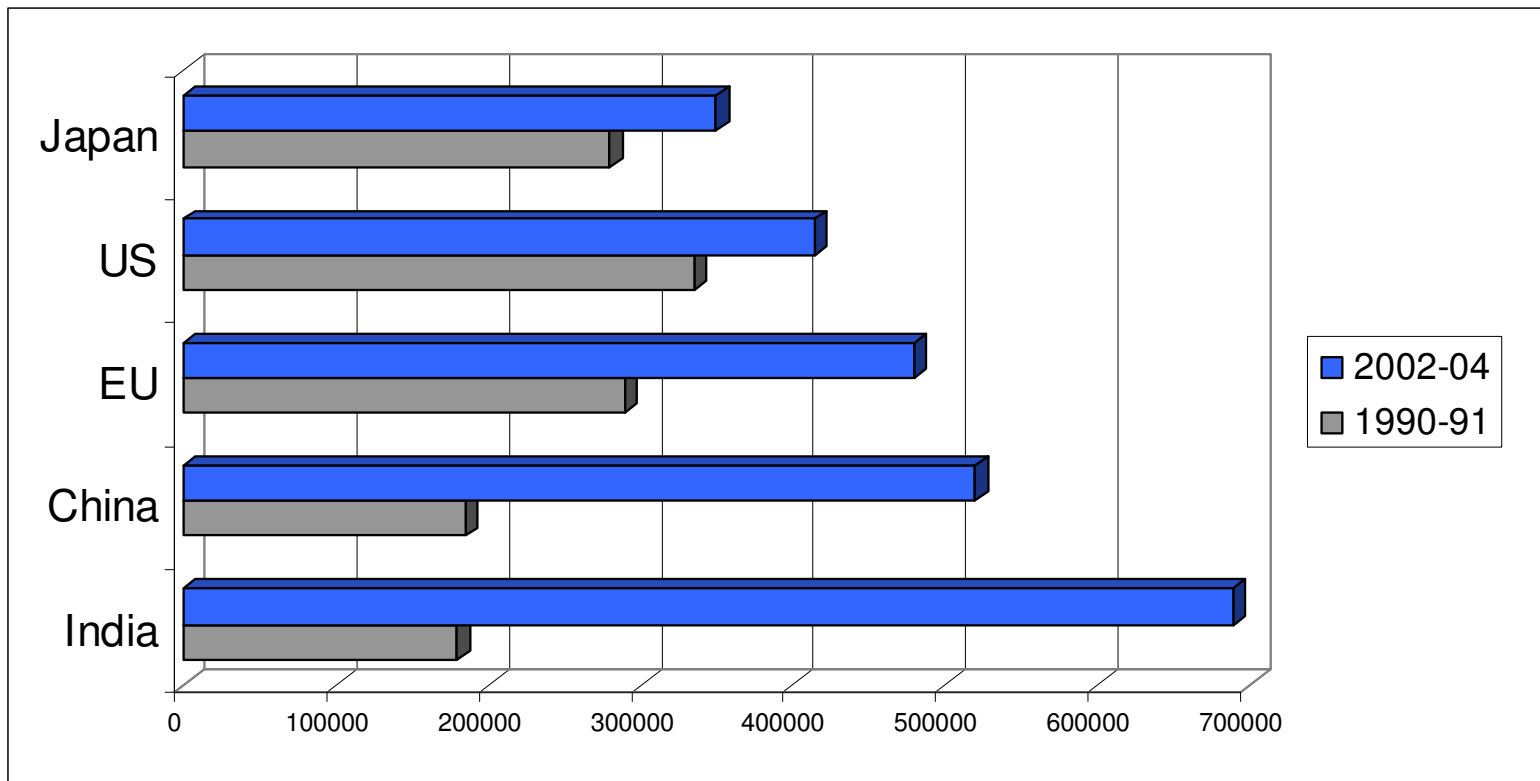
Source: The Economist, IMF, Morgan Stanley Capital International, BP. October 2006.

Growth: Demographics



Growth: Rising Skill Levels

University Graduates in Engineering & Science



Source: Eurostat 2003 and JP Morgan – June 05

No longer just manufacturing

The Strategic Case for Investing in GEM

- **The strategic case for emerging markets**
 - **Share of global GDP is not reflected in current market cap.**
 - **Faster economic growth- two to four times faster than G7**
 - **Improving political and corporate governance**
 - **Demographics are advantageous**
 - **Greater scope for productivity gains**
 - **Increasingly skilled workforces**

Compelling reasons to have exposure

Emerging Markets Within The Portfolio

Long term correlation with Major Equity Markets

5 years correlation	MSCI EM	MSCI World	S&P500	TOPIX	FTSE 100	MSCI Europe
MSCI EM	1					
MSCI World	0.84	1				
S&P500	0.68	0.94	1			
TOPIX	0.57	0.55	0.39	1		
FTSE 100	0.78	0.87	0.73	0.42	1	
MSCI Europe	0.81	0.94	0.82	0.42	0.94	1

20 years correlation	MSCI EM	MSCI World	S&P500	TOPIX	FTSE 100	MSCI Europe
MSCI EM	1					
MSCI World	0.66	1				
S&P500	0.60	0.86	1			
TOPIX	0.39	0.68	0.34	1		
FTSE 100	0.51	0.82	0.69	0.45	1	
MSCI Europe	0.59	0.89	0.73	0.47	0.90	1

Source: Datastream, Nomura. Monthly data as of 31/08/2008

Emerging Markets Within The Portfolio

Higher absolute and risk-adjusted returns

Look-back period	5 years		
	Returns (%)	Standard deviation (%)	Return per unit of risk
MSCI World	10.8	10.2	1.1
S&P 500	6.9	9.5	0.7
MSCI EM	23.9	19.7	1.2
MSCI Europe	15.7	12.5	1.3
TOPIX	7.4	14.5	0.5

Look-back period	10 years		
	Returns (%)	Standard deviation (%)	Return per unit of risk
MSCI World	5.8	13.8	0.4
S&P 500	4.7	14.2	0.3
MSCI EM	17.7	21.7	0.8
MSCI Europe	6.5	15.7	0.4
TOPIX	5.1	18.5	0.3

Source: Datastream, Nomura. Monthly data as of 31/08/2008

Note: annualised return and standard deviation data

GEM: *is now a good time to invest?*

- **Emerging markets have outperformed in recent years, but value remains:**
 - PE levels are at a discount to developed markets and in line with their 10 year averages
 - Earnings growth is stronger: IBIS forecast of 10.3% in FY08 is three times the 3% earnings growth expected from developed markets
 - Dividend yields and RoE higher than developed markets

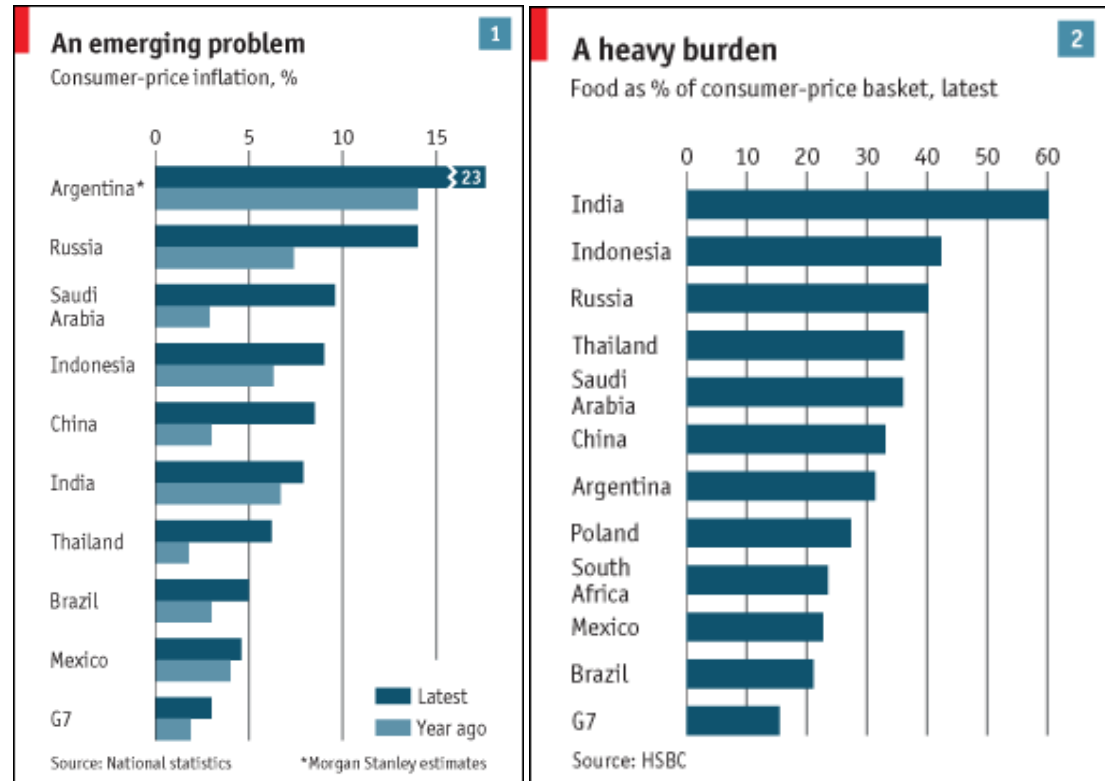
	Forward PE*		Price to Book		Dividend Yield		ROE	
	Current	10 yr avg.	Current	10 yr avg.	Current	10 yr avg.	Current	10 yr avg.
Emerging	10.2	10.0	1.9	1.7	3.5	3.2	19.5	17.5
World	11.6	17.5	1.7	2.4	3.2	2.2	15.8	14.6
USA	13.0	18.3	2.0	2.8	2.3	1.8	16.1	16.4
Japan	15.0	23.7	1.4	1.8	1.9	1.1	10.0	8.3
UK	9.0	14.4	1.6	2.2	4.5	3.3	18.7	16.0
Europe ex UK	9.8	15.3	1.5	2.3	4.6	2.8	15.9	15.1

* 12 month forward IBES consensus estimates

Sources: data has been sourced from Nomura International plc, FTSE Group, Thomson Financial Limited and Bloomberg Inc. August 2008

Emerging Markets – some current issues

- Commodity boom
- Inflation
 - Food and fuel large parts of CPI indices
 - Protests and some political unrest
 - Food prices- some signs of improvement?
- Decoupling?
 - Still connected, but more resilient



Source: The Economist, 22nd May 2008

Where Do Emerging Markets Fit Within Portfolios?

- **A higher risk/return asset class**
 - **Compliments a Global Equity Mandate?**
- **Risk diversification benefits**
 - **Plus a higher longer term return per unit of risk than for developed markets**
- **A long term, strategic, asset allocation decision**
 - **Timing always a problem but:**
 - **Pension funds can adopt a longer term perspective**
 - **Where does the future consumer reside?**

Emerging Markets– The Challenge

- 🌐 **3 Regions (Asia 52%, EMEA 26%, Latin America 22%)**
- 🌐 **27 Countries (MSCI)**
- 🌐 **27 Currencies**
- 🌐 **79 Languages**
- 🌐 **839 Stocks in the benchmark (MSCI)**

How best to capture the alpha?

Source: Morgan Stanley Capital International (April 2008)

Oliver Wyman carried out independent research on behalf of Nomura to test the regional composite approach against two metrics

1. Pure returns performance

- How would an aggregate global EM fund made of regional specialists have performed versus typical single manager global EM funds?

2. Risk adjusted returns

- Is there historical evidence that (on a standalone basis) Regional funds in general are more or less volatile than global funds?
- Is there historical evidence to suggest that a composite fund (comprising of a combination of regional funds) is more or less volatile (i.e. offers better risk adjusted returns) than the global funds?

Analysis was carried out on a dataset comprising of a sample size of 406 funds, covering >\$300 BN of AuM, ~30% of which is from specialist regional funds

Global		LatAM		Asia Pac		Eastern Europe	
Fund name	AuM (\$BN)	Fund name	AuM (\$BN)	Fund name	AuM (\$BN)	Fund name	AuM (\$BN)
1. American Funds – New World Fund	18.0	JPMorgan Funds – Latin America Equity Fund	2.2	Matthews Pacific Tiger Fund	4.0	Baring Global Umbrella – Baring Eastern Europe Fund	3.9
2. GMO Emerging Markets Fund	14.3	Threadneedle Investment Funds ICVC – Latin America Fund	2.0	Target Asia Fund Ltd	2.4	JPMorgan Funds – Eastern Europe Equity Fund	2.6
3. Oppenheimer Developing Markets Fund	12.3	Morgan Stanley SICAV – Latin American Equity Fund	1.7	Mellon Global Funds PLC – Asian Equity Fund	1.9	Pioneer Funds – Eastern European Equity	2.1
4. JPMorgan Funds – Emerging Markets Equity Fund	8.4	Fidelity Funds – Latin America Fund	1.4	Threadneedle Investment Funds ICVC – Asia Fund	1.7	Raiffeisen-Osteuropa-Aktien	1.8
5. DFA Emerging Markets Value Portfolio	7.8	Baring Emerging Markets Umbrella – Baring Latin America Fund	1.2	First State Investments ICVC – Asia Pacific Fund	1.7	Pictet Funds Lux – Eastern Europe	1.7
Next 5	28.0		2.5		6.5		6.8
Next 40	76.3		2.5		17.0		12.3
Next 100	39.6		NA		NA		NA
Rest	1.1		0.0		4.3		0.4
Total	205.8		13.5		39.5		31.6
Number of funds	188		35		111		63

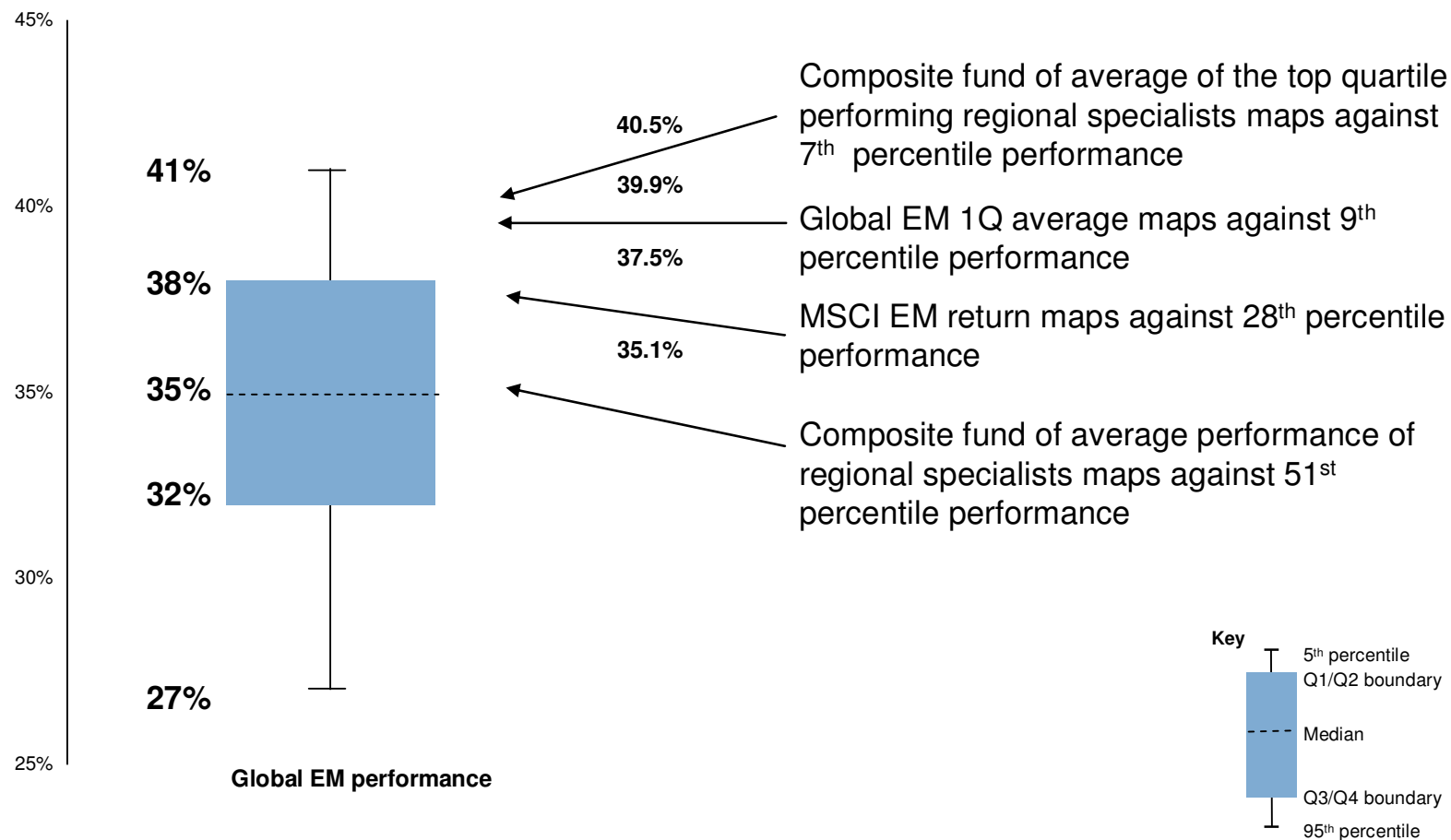
List also includes the following well known EM names

- Pictet
- Frank Russell
- Fidelity

Source: Bloomberg, Oliver Wyman analysis

Over five years period the case for regional managers remains compelling

Five year annualised total returns

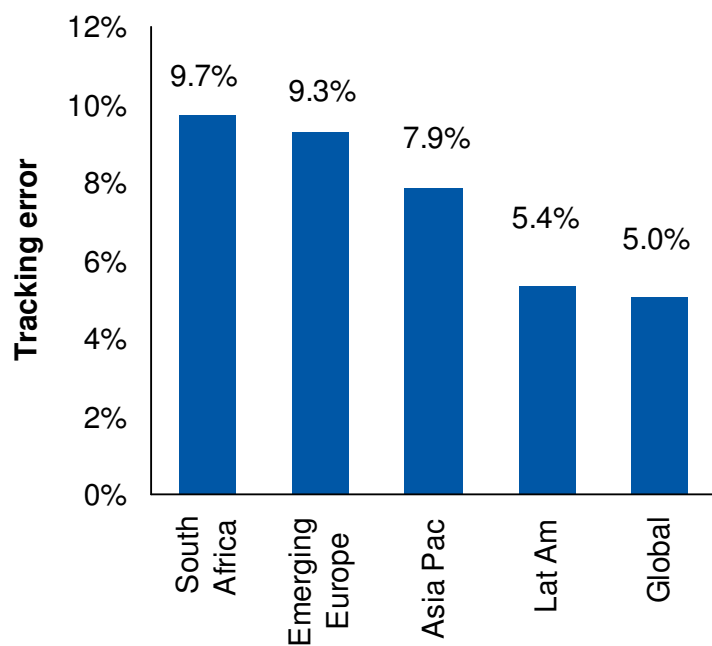


Source: Bloomberg, Oliver Wyman analysis

On a standalone basis analysis regional fund managers in the sample have larger tracking errors than the global funds

Global vs. regional manager

Average tracking error comparison over 5 years



No. Funds	5	59	105	35	179

Comments

- On a standalone basis the regional funds have an average tracking error of around 7.9%
- Single manager Global funds have an average tracking error of 5.0% over the five year time period
- Global fund tracking errors are consistently lower than regional funds over the 1, 3, 5 and 7 year time frames
- One rationale for this could be the differing investment strategies, as regional funds are more likely to invest in more volatile small and mid cap stocks

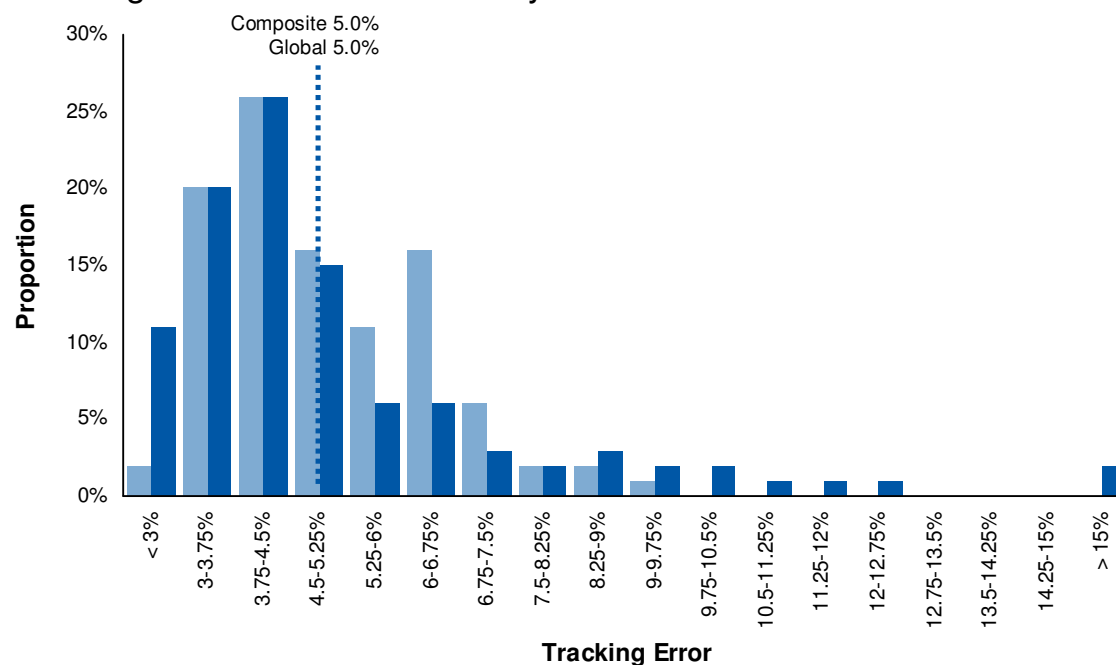
Source: Bloomberg, Nomura, Oliver Wyman analysis

Note: Gross performance as provided by Nomura, Synthetic data used until April 2006, live returns data used thereafter

However, on a composite basis these funds are only as risky as the global managers

Global vs. composites fund

Tracking error distribution over 5 years



Average Tracking error	
Global funds (179)	5.0%
Composite funds (179)	5.0%

Comments

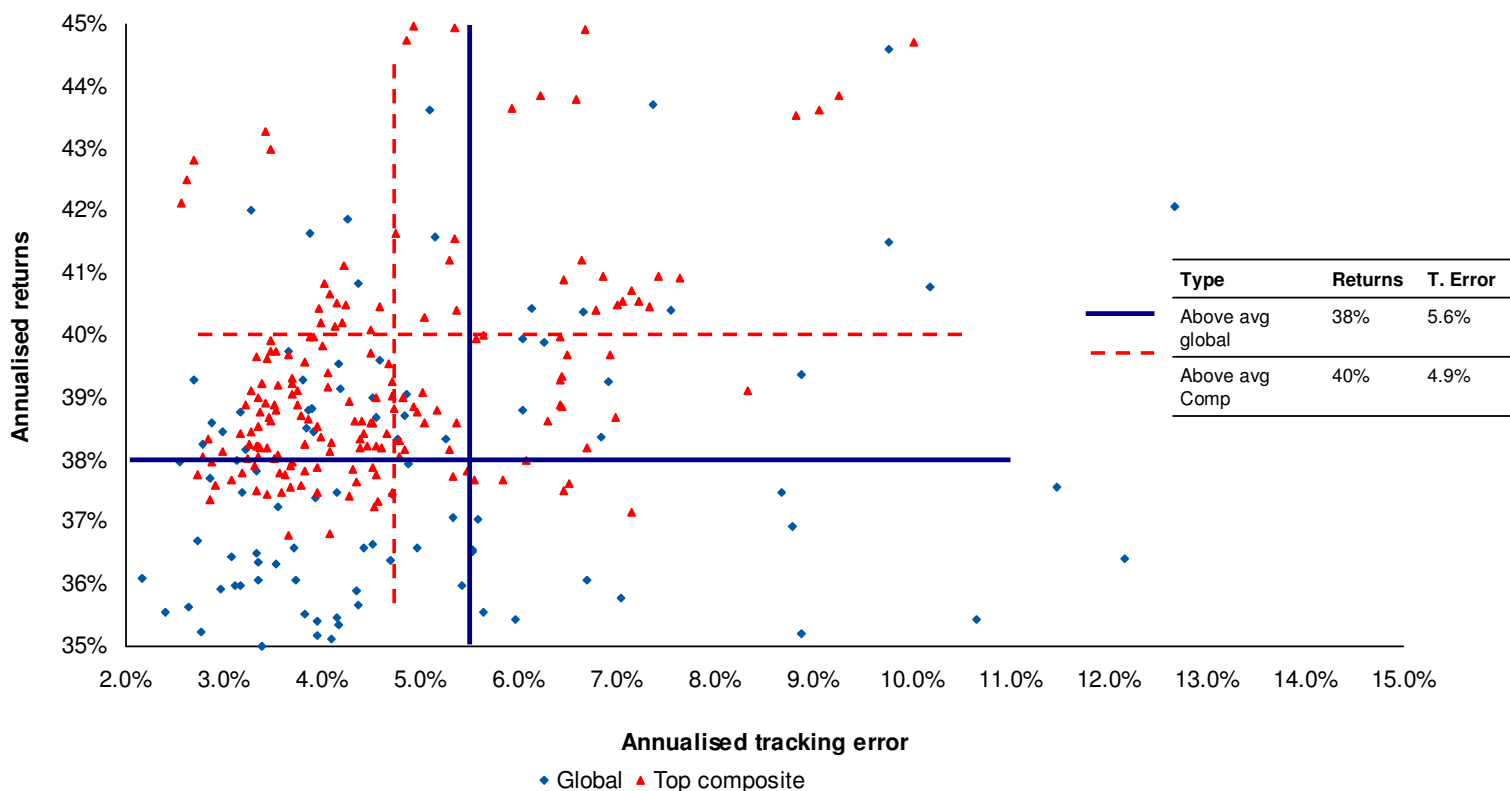
- The average tracking error for composites funds is at most as risky as single manager global funds
- There are two diversifying effects
 - Larger number of holdings relative to a global fund
 - Beneficial diversification due to more “local” nature of regional EM holdings

Source: Bloomberg, Nomura, Oliver Wyman analysis

Note: Gross performance as provided by Nomura, Synthetic data used until April 2006, live returns data used thereafter

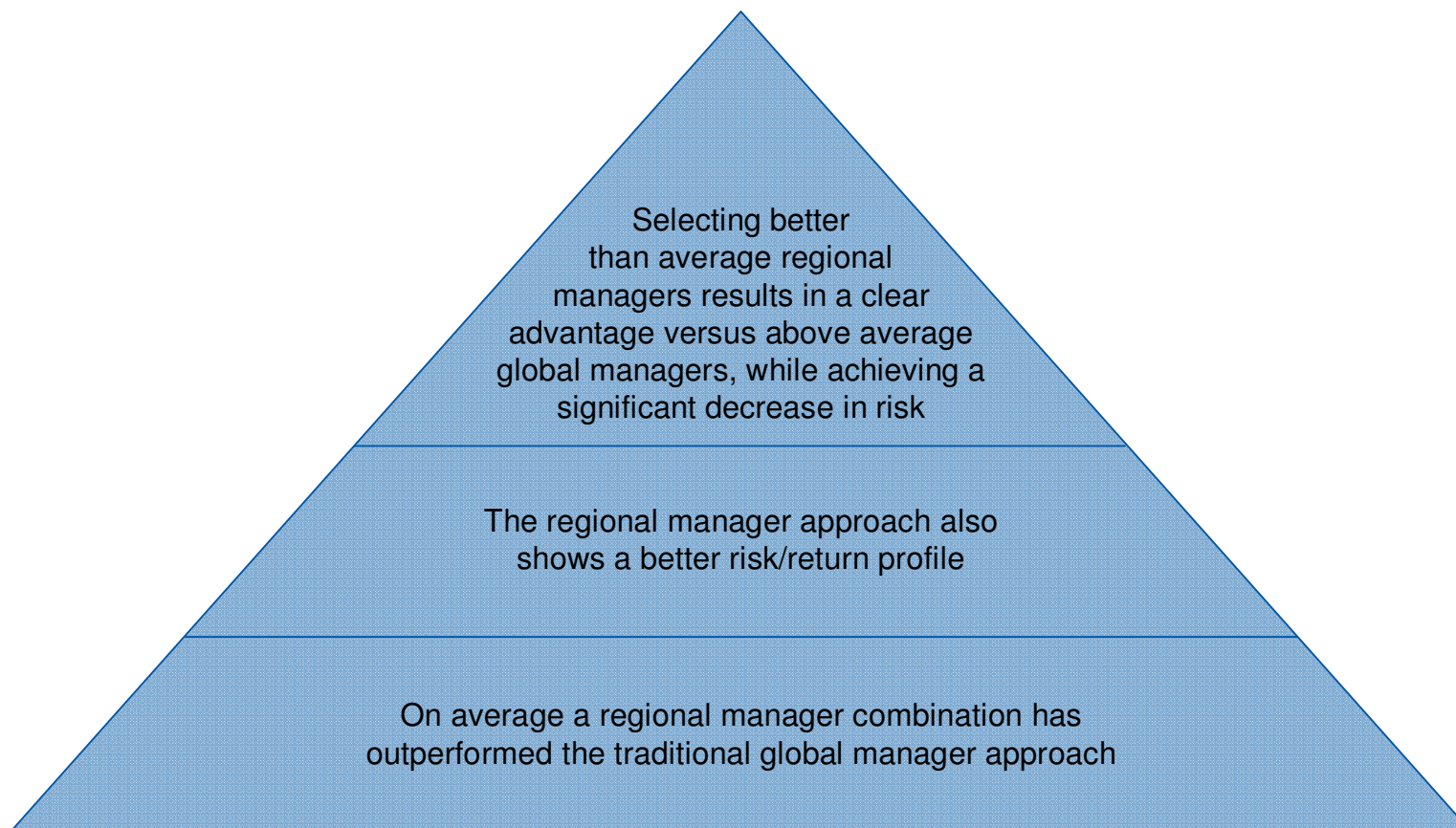
A composite fund consisting of above average regional managers outperforms above average global managers by 2% points whilst achieving a significant decrease in TE

Above average global funds vs. above average composite funds
Returns vs. tracking error over 5 years







Source: Bloomberg, MSCI, Nomura, Oliver Wyman analysis. Note: Gross performance as provided by Nomura, Synthetic data used until April 2006, live returns data used thereafter
Note: Above average funds are defined as funds comprised of managers with above average returns over the defined time period

The rationale underlying the regional specialist approach to EM management is therefore supported by our research



Note: Performance references refer to analysis of annualised numbers over one, three and five years

Global Emerging Markets – Summary

-  **An attractive asset class...but a challenging mandate!**
-  **Best viewed as a strategic asset allocation decision within your overall equity allocation**
-  **As far as alpha is concerned the Oliver Wyman research shows that a combination of top regional specialists significantly outperforms the average global emerging markets manager - whilst reducing risk**
-  **Something we believe will increasingly feature in pension fund assets.....**

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Nomura Asset Management U.K. Limited has compensated Oliver Wyman Limited to analyse Nomura Asset Management's Global Emerging Market's strategy and to prepare this document. Oliver Wyman has prepared a longer version of the document which contains more detailed information on the analysis, including further information regarding comparative performance.

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