



Insights, Tacit Thought | Weekly Investment Insights

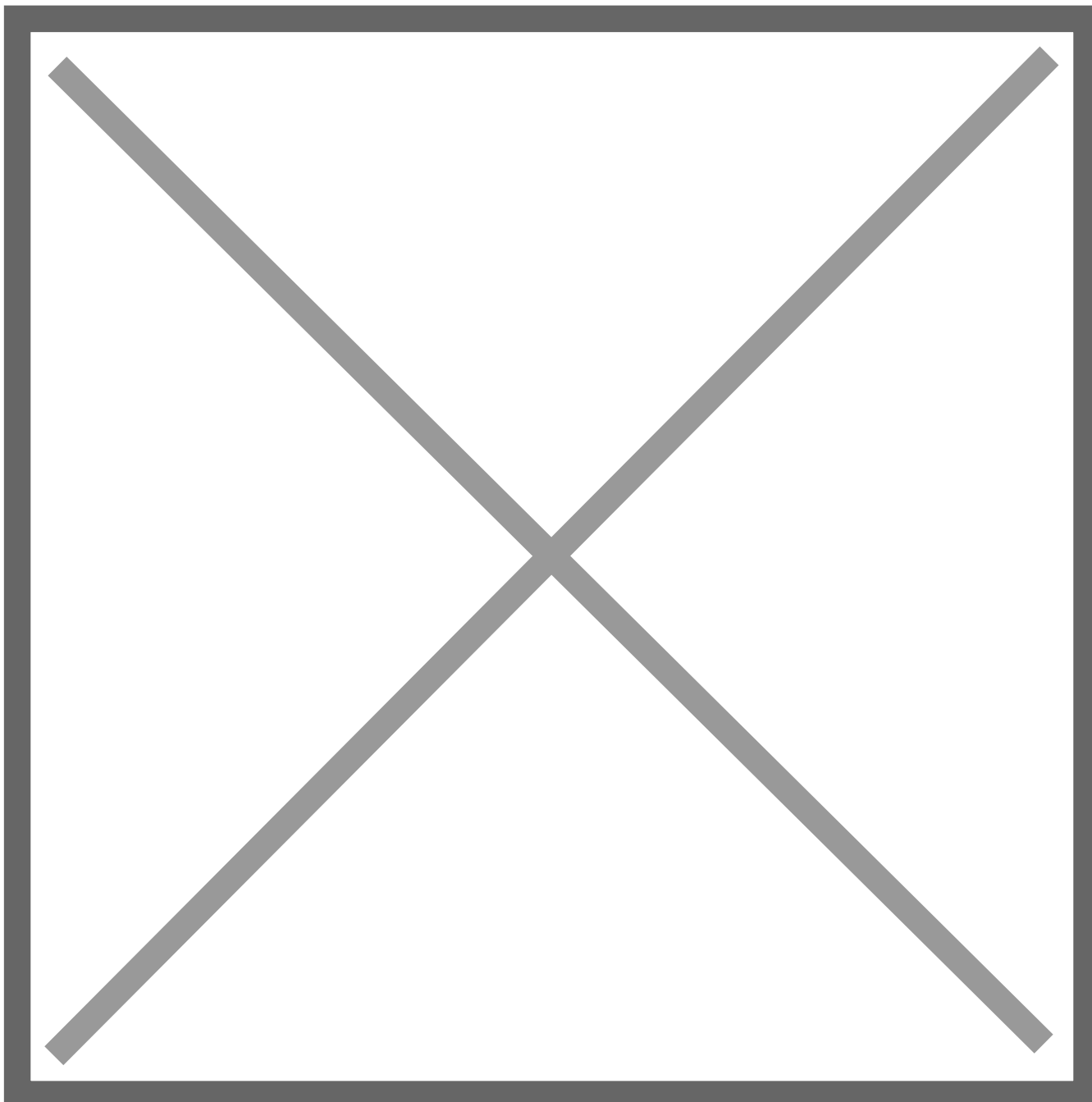
Avoiding Cockroaches

Published on: 7 September, 2018 | Author: Investment Team

"In the world of business, bad news often surfaces serially: you see a cockroach in your kitchen; as the days go by, you meet his relatives"- Buffett

There has been a lot of coverage about the recent melt-up in emerging markets. Since the start of the year the Turkish Lira and Argentine Peso have plunged by almost 50% against the Pound, the Shanghai composite index has fallen by almost 20% (a technical bear market) and the South African economy has entered a recession. Smaller Asian economies like the Philippines, Indonesia and Malaysia are also struggling with inflation and a stagnating economy.

Emerging market economies look to be in bad shape however, they are not a monolith. Take India for example. It retains its throne as the [fastest growing major economy](#). Since the start of the year, Indian equities have also performed reasonably well despite the change of fortune for its neighbours and other emerging economies.



In investing, avoiding the losers is just as important as picking winners. This year we have dodged the train wreck that is the bulk of emerging markets. We have some exposure to India and China however these have not had any meaningful effect on our strategies.

Emerging markets are naturally riskier than developed markets. Now, we don't mind taking a risk but we have to be paid for it. A larger margin of safety is required when investing in emerging markets because of externalities that are unpredictable and largely out of our control.

What are some of these externalities? Well for one, most emerging markets are commodity heavy economies. Their prosperity is closely tied to the price of oil, metal or agricultural products. Forecasting future commodity prices is a fool's errand. In March 2015, ten analysts surveyed by the Wall Street Journal predicted oil prices of \$50 per barrel by December that year. Come December, ten analysts were wrong and prices were almost \$30 per barrel.

Investing in emerging markets has the added headache of foreign exchange risk. The large declines in the Turkish Lira and Argentine Peso will magnify any losses experienced by their equity markets for the UK investor.

Emerging markets can provide ample opportunities for the intelligent investor. They have a young labour force and low debt levels with a large runway for growth compared to more developed economies. However, there is an added layer of risk because of corruption and lack of strong institutions. We never want to be in the position where we have to tell one of our clients that Putin has seized their assets.

Because of the larger risks involved, any investment idea in emerging markets must jump through several hurdles before it is added to our strategies. This will help us avoid future cockroaches once we spot the first one.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act 2000. Please note, tax and estate planning services are not regulated by the FCA.