February 16, 2011

WEALTH ADVISER
Emerging Market Exposure Kept In Check
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NEW YORK -- Egypt's political revolution is providing financial advisers with the perfect opportunity to emphasize to investors why they shouldn't become over enthusiastic about emerging markets.

Most advisers have very little exposure to Egypt or the broader Middle East, so there is no shifting of portfolios going on and little direct concern among their clientele.

But the turmoil, which shows signs of spreading to other parts of the Middle East, highlights the dilemma for advisers who want to capture the growth potential that emerging markets offer. If they load up with exposure to these promising but volatile nations, they risk unnerving investors who are keeping a close watch on quarterly statements. If they don't partake, clients may take them to task for passing up juicy returns.

"This is a great example of why we don't get too excited about those out-sized returns in emerging markets," says Troy Sapp, a financial planner at Commencement Financial Planning LLC, a fee-only advisory firm in Tacoma, Wash., which oversees $14 million. "We never know where these crises are going to pop, where the opportunities are going to pop. What we do know is they're volatile."


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Martin Shields, a certified financial planner at West Financial Services Inc. in McLean, Va., says the main concern on his clients' minds these days is much closer to home: the U.S. municipal market. Their exposure to Egypt is negligible.

West Financial Services, a division of Sandy Spring Bank, has about $750 million in assets under management. Of a client's total equity portfolio, about 25% is invested in international stocks, and, depending on the client, about 20% to 30% of that international chunk is in emerging markets through mutual funds and exchange-traded funds, he said.

Shields calls his firm's approach "pretty conservative," but he notes, "A lot of advisers are increasing that exposure because that's where the growth is going to be long term."

Short-term it can be a different story: This year through Feb. 11, the Standard & Poor's 500 Index has gained about 5.5%, while the MSCI Emerging Markets Index is down about 5%.

"If you went more heavily into emerging markets, suddenly your client's portfolio is not doing quite as well as it had been during past years, when it outperformed the S&P 500 because of its allocation to emerging markets," says Shields.

John Smartt Jr., an adviser in Knoxville, Tenn., says his clients' portfolios have 10% international exposure through Vanguard FTSE All-World Ex-US (VEU). The fund had 25.7% of its assets in emerging markets as of Jan. 31. His clients have little exposure to Egypt, says Smartt, who oversees about $21 million in assets.

"When we diversify, we give up making a killing in turn for not being killed," he says. "That also means we don't have to worry about Egypt."

Sapp notes that Egypt constitutes just 0.2% to 0.3% of the typical emerging markets indexes. "Prudent investors would not have exposed themselves to this inherently risky country in a manner which would have posed material risk to their portfolios in the first place," he says.

Peter North, a certified financial planner at North & Co. in Bath, Maine, and Fleming Island, Fla., also has about 10% of his clients' overall portfolios invested in emerging markets. With Egypt accounting for so little of emerging markets indexes, he says, "It's unfortunate that the Egypt situation has somehow given people that perception of increased risk to emerging markets."

North hasn't made any changes to his portfolio as a result of the turmoil, but is considering taking some energy ETF gains off the table. He believes they occurred, in part, due to the situation in Egypt and fears of possible contagion.