Investors considering emerging markets equities are confronted with a myriad of implementation options with respect to investment managers, strategies and vehicles. In addition to decisions regarding style allocation, market capitalization emphasis and currency hedging (among other considerations), the question of global versus regional emerging markets is important to address.
This paper highlights what we believe are a few key benefits of a global approach to emerging markets equity investing. While regional or country-focused strategies may make sense for some investors given their unique objectives, the following analysis of relative country, sector and market cap exposures, in addition to risk-adjusted returns, supports the view that a globally diversified allocation to emerging markets is advantageous for a large percentage of investors.

**Country Exposure**

Diversification across a relatively significant number of countries is a benefit of global emerging markets strategies. The MSCI Emerging Markets indices illustrate this point. As of June 30, 2012 the MSCI Emerging Markets (EM) Index included 21 countries, compared to 8 countries each in the MSCI Emerging Asia and EMEA indices, and only 5 countries in MSCI Latin America.

As the pie charts indicate, a handful of countries dominate the regional indices. The top 3 countries in the broad MSCI EM Index accounted for 46% of the total Index weight. While this is not an insignificant amount, it compares favorably from a diversification point of view versus Emerging Asia (74%), Latin America (91%) and EMEA (86%).
**Sector Diversification**

A review of sector exposures is also informative when considering global versus regional emerging markets investing. The following chart illustrates the more diversified sector composition of the broad index relative to the regional indices.

![MSCI Sector Weightings as of 6/30/12 (%)](chart)

**Sources:** Factset

Emerging Asia is relatively concentrated in Information Technology and Financials, while Latin America has notably higher Materials and Consumer Staples exposures. EMEA's Energy weighting is approximately double that of the broad index, primarily the result of a few larger cap Russian oil & gas companies. As a result, individual regions behave similarly to specific sectors, which reduces diversification potential.

**10 Year Correlations as of 6/30/12**

![10 Year Correlations as of 6/30/12](chart)

**Sources:** Bloomberg, MSCI Emerging Markets monthly returns.

**Market Capitalization and Holdings Concentration**

The following market cap composition chart highlights the Latin America region's sizable allocation to the largest cap companies (>50B in total market cap).

![Market Capitalization as of 6/30/12](chart)

**Sources:** Factset

Drilling deeper into market composition at the company level, it is interesting to see the significant weighting impact of the largest market cap companies in each region.
Latin America and EMEA are particularly concentrated markets, with the five largest companies comprising over 25% of their respective total market capitalizations. A broad geographic approach can help to mitigate this concentration risk through an expanded opportunity set, with a significantly higher number of investable companies.

**Risk-Adjusted Investment Performance**

An analysis of historical risk-adjusted performance and correlations within an efficient frontier framework is also supportive of a global emerging markets allocation. The following chart combines efficient frontiers for combinations of the broad emerging markets benchmark and each of the primary regional benchmarks, based on 10 year historical performance and standard deviation, combined with longer-term correlations (source: Factset).

The efficient frontier results demonstrate the substantial diversification benefits of a global approach, as risk is reduced with higher allocations to the broad MSCI Emerging Markets portfolio. While Latin America by itself significantly outperformed the broad index over the 10 year period, this excess return was produced with greater volatility. In contrast, the broad portfolio outperformed the 100% Emerging Asia portfolio at approximately the same level of risk. The 100% EMEA portfolio also produced inferior risk-adjusted performance relative to the broad portfolio.
Strategic Weightings vs. Diversified Portfolio

While an investor may invest in individual regions and adjust weightings based on a strategic outlook, this structure may reduce alpha potential. For instance, given the concentrated nature of each region, regional managers may feel compelled to maintain some exposure to the high index weighting companies for risk management purposes given the concentration of the regional indices. Conversely, a diversified emerging markets manager with a wider opportunity set may be more apt to add value given a broader selection universe where the best ideas are incorporated, regardless of country origin or sector membership.

William Blair’s global and international equity strategies have always cast a wide net across geographies in our pursuit of high quality growth companies. Our “go-anywhere” mentality has resulted in consistent emerging markets exposure in our broad strategies over time, while facilitating a more diversified allocation within our dedicated emerging markets portfolios.

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