DIVERSIFICATION RISK INDICATOR COMMENTARY

Emerging Markets Update, September 2018

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Emerging markets have recently dropped over 20% from their peak on January 26 and are bouncing in and out of a technical bear market.

Emerging markets are no longer an avoidable exposure to a diversified investor. The top seven emerging markets have almost doubled their contribution to the global GDP since the 1990s. In addition, several companies in developed markets derive significant growth from their exposures to consumers in these regions.

The recent market action in an important capital market has investors re-assessing their risk exposures and re-evaluating their portfolios for protective dams and levees. The journey towards and into bear territory poses the potential for significant damage to investors. These damages driven through extreme losses are the ones that cause emotional trauma and force you to modify your retirement or spending plans. Investors haven't seen such markets in the US for almost a decade now. The price action in an important global market is a timely reminder for some mental preparation and practical checks.

Some lessons can be learned from the experience of the clients who, through their advisors, have accessed the 55ip algorithms that seek to decrease the likelihood of extreme losses. Many investors have built portfolios to make sure they are exposed to the entire global GDP, rather than only a subset.

So, it is natural to ask whether emerging market exposure reduces risk or, as recent markets suggest, increases risk. The short answer is both - just at different times.

This is precisely where the 55ip Diversification Risk Indicator (55ip) seeks to provide investors with guidance on when international diversification is prudent. 55ip' s investment science seeks to reduce the likelihood that investors will be impacted by such extreme losses in international markets relative to domestic markets.

To be sure, strategies that seek to reduce risk have costs. Emerging markets will rally, and the attention to avoiding extreme losses will be reason this investor will not fully participate in the upside. This is not their goal either. A steadier return stream is what drove the initial desire to gain broad-based exposure and remains 55ip's objective. Any participation that is similar or higher during the upside would be icing on the cake. Further, more active trading has costs, including taxes in accounts that are taxable.

Historical evidence suggests any investor looking to add international exposure to their portfolio should balance the genuine value of these important and high growth markets with the danger of fast and furious moves. 55ip can help - ask your 55ip representative about it for clients who seek broad based equity exposures.

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