

# A case for emerging market investment

**T**he long rally in Asian, Eastern European, Russian and Latin American assets continues. Albeit with lower returns than the double-digit returns of recent years, investors still seek exposure to emerging markets and some of the attention is shifting from Asia to other regions, such as Eastern Europe, where growth prospects are very attractive. However, barriers to entry in these markets persist for foreign investors, although they can be overcome through innovative structured solutions.

## Opportunities

For more than two years, growth in Asia ex-Japan has outpaced the global economy. Companies have restructured significantly since the 1997-98 financial crisis, showing stronger balance sheets, dramatic earnings increases and a steady rise in payout ratios and dividend yields. Therefore, attractive investment opportunities remain in the region, especially in the telecoms, consumer goods and utilities sectors.

Central and Eastern Europe (CEE) countries are now showing distinct similarities to emerging Asia in the early 1990s. Five countries in the region joined the European Union in May 2004 (Czech Republic, Hungary, Poland, Slovakia and Slovenia), most of them generating strong GDP growth in 2004. Economic growth in CEE is expected to continue at rates 2% to 3% (inflation deducted) higher than the average for Western Europe. We believe Central and Eastern European stocks should do well in 2005, especially in Hungary, Poland and the Czech Republic, where major privatisation programmes have been undertaken.

## Restrictions to investment

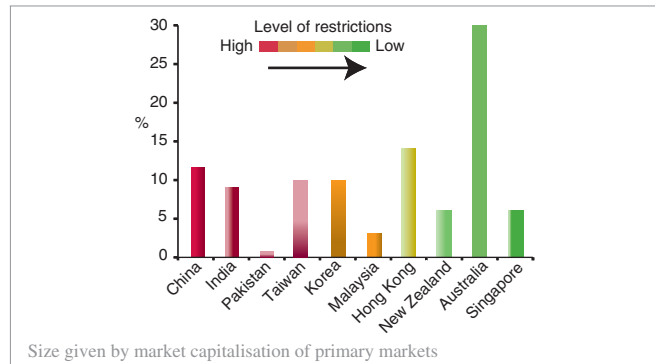
Although enticing, opportunities to trade emerging stocks and indices can be limited by a number of market restrictions. In Asia, almost 50% of the markets are restricted to varying degrees, with barriers to foreign investment, profit repatriation, currency convertibility and short selling, adding to complex approval and registration regimes and taxes on foreign investment.

In China for example, a foreign institution cannot invest directly in the Chinese equity markets unless it is registered as a "Qualified Foreign Institution Investor" (QFII). Only four large funds management companies had QFII status as of February 2005 plus a few large investment banks, including BNP Paribas.

## Solutions to access restricted markets

To overcome the barriers to entry on the Chinese stock markets, BNP Paribas has issued offshore USD-denominated listed certificates,

## Level of restrictions on Asian markets



thereby eliminating the need for QFII application and repatriation constraints, as well as settlement, custodial and currency issues. By buying a certificate, investors gain immediate access to the underlying shares and currency. These certificates exist on any stock listed on the Shanghai and Shenzhen Stock Exchanges – aside from a dozen relatively small companies – accounting for around 1,300 stocks.

Moreover, more exotic structures can also be developed on a case-by-case basis on Chinese equities and the Chinese index. Short-term structures with early redemption features have been highly successful, such as *Callable Performance Amplifiers* based on Chinese stocks. This 100% principal-protected product can redeem capital plus a high coupon at each quarter, otherwise investors receive an amplified final performance at maturity of three years (e.g. 600% of the basket's final performance, each stock being capped at a predefined level).

Structured products linked to Eastern European markets are also developing rapidly. The underlying recommended for playing economic development in this region is the CECEUR index (which turned in a performance of +58.49% in 2004). Structures with more sophisticated yield profiles have emerged, such as "Stellar" or "Hybrid" pay-offs, as well as *Dual Currency* structures offering exposure to currency risk and no exposure to equities.

This increased innovation coupled with booming investor appeal is a very promising trend, paving the way for new developments in structured products on emerging markets. ●

## Contact:

**Christian Kwek**, global head of structured products marketing  
 t: +44 (0)20 7595 8641 e: christian.kwek@bnpparibas.com