PEI Alternative Insight

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FOR THE WORLD'S PRIVATE EQUITY MARKETS

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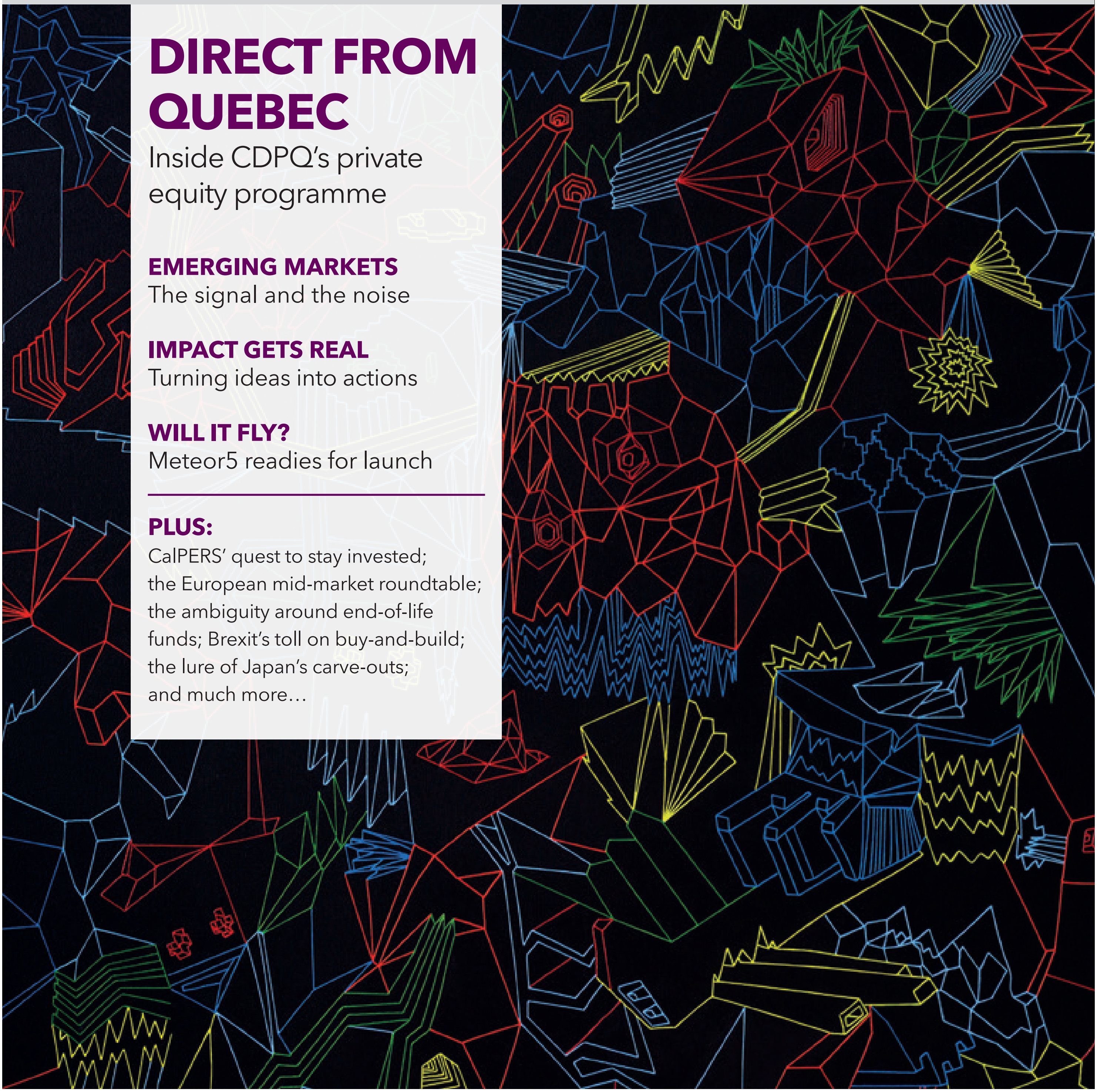

DIRECT FROM QUEBEC

Inside CDPQ's private equity programme

EMERGING MARKETS

The signal and the noise

IMPACT GETS REAL

Turning ideas into actions

WILL IT FLY?

Meteor5 readies for launch

PLUS:

CalPERS' quest to stay invested; the European mid-market roundtable; the ambiguity around end-of-life funds; Brexit's toll on buy-and-build; the lure of Japan's carve-outs; and much more…

IFC

'You can't throw a dart and always win'

Emerging markets will drive global growth, but investors still need to be selective, says International Finance Corporation Asset Management Company deputy CEO and COO Ruth Horowitz

Using emerging markets as a catch-all term is probably wrong at this point

***Horowitz**: seeing more diversification into emerging markets*

Q What is your outlook on the global economy and emerging markets?

Ruth Horowitz: We are overall positive on emerging markets; we believe they are really going to be the energy for the world's growth going forward. More than half of the world's GDP now comes from these regions. You have a couple of huge trends happening in emerging markets. You have urbanisation as countries get slightly richer, people moving towards cities, which tends to lead towards better economies but also enormous opportunities for investment. You have a growing middle class, which starts to spend more on discretionary. And then you have the demographic side; large pieces of the population that is young and that wants to work.

But we need to be selective. Using emerging markets as a catch-all term is probably wrong at this point because you have different levels of income, different levels of regulatory and financial development, different levels of political risk and stability, different levels of comfort from outside investors coming in. As you look at the economies of developing countries, you need to look country by country. We say we're bullish on emerging markets because in aggregate they will grow faster over time than the developed economies. But that doesn't mean you can throw a dart and always win.

Q With investments in so many different countries, how do you manage currency risk?

RH: Currency risk is a huge issue for us and we're dealing with that on a constant basis. There is a couple of things we do. First, we run US dollar-based funds, but our investors understand nothing we're investing in is in US dollars, so we can provide diversification for those investors even just with the spread of currencies we have across the portfolio.

The second thing is when we think about our portfolios we try to make sure we don't end up with a concentration of any one single currency or a series of currencies that are all dependent on one thing, such as the price of oil.

Thirdly, we build currency depreciation into every model. We have access to fantastic economic research by being part of the World Bank Group. We look at inflation projections and we build depreciation. We never assume appreciation. If there's appreciation, that's a wonderful side benefit. Depreciation needs to hit our thresholds to make the portfolio.

Q Have you considered hedging?

RH: We've explored hedging. Hedging for the long term when you don't know when you're going to exit is extremely expensive. We will hedge short term if we know we have an exit coming. Currencies have had as much impact on our portfolio as company performance over the last couple of years because the dollar has just been on such a great tear.

Q Are you concerned about returns in private equity and whether that might influence investors' decision to allocate to emerging markets?

RH: That's always a concern because investors have alternatives; they can always keep their money where it is, and for the last couple of years the developed markets have had really strong performance on both a public and a private basis. The perception is that developed market investing is less risky than emerging market investing. We can debate whether that's correct or not, but we are seeing more investors starting to talk about diversification of their portfolio and not having all of their exposure into developed markets. ■