

Greetings!

**Do you know why most emerging markets funds outperformed US markets in 2017?** It is not, as popularly believed, because of the impressive ~50% growth in emerging markets' stock market indices like Argentina, Nigeria, and Poland<sup>1</sup> -- these countries combined are just over 1% of MSCI Emerging Market (EM) indices.<sup>2</sup> Emerging markets outperformed because two of the funds' biggest holdings, Tencent and Alibaba which constitute 10% of MSCI's EM index,<sup>3</sup> were up 113% and 97% respectively.<sup>4</sup> Emerging Markets outperformed because the benchmarks have been reconstructed to be an amalgam of Asian tech stocks instead of a broad representation of emerging market stocks.

**The MSCI Emerging Markets index, which is the benchmark for over \$1.6 trillion<sup>5</sup> in assets for both active mutual funds and passive ETFs, is misleading because:**

*1) Asia is over 70% of the index<sup>6</sup>, belittling the representation of other regions of the world;*

*2) South Korea and Taiwan are over 25% of the EM index<sup>7</sup>, even though the International Monetary Fund considers these to be advanced economies<sup>8</sup>;*

*3) The index is composed of a basket of idiosyncratic stocks, not aggregated country indices;*

*4) Tech stocks are 27% of the MSCI EM index vs. 14% of the MSCI All-World Index. This tech dominance does not necessarily represent the region's indices -- the iShares Large-Cap China ETF (FXI) is just 9% technology but 50% Financials, 10% Real Estate, and 9% Energy.<sup>9</sup>*

**MSCI has changed its methodology based on "free-float market cap" which has resulted in the following oddities:**

*A) Tencent and Alibaba have a higher weighting than all of India, which has over 1.3 billion people, and is the world's 6th largest economy with \$2.3 trillion annual GDP per the IMF.<sup>10</sup>*

*B) Tencent is double the weighting of all of Russia, an economy with \$1.3 trillion GDP<sup>11</sup>*

*C) Brazil has a higher GDP and 4X the amount of people as S. Korea but is just 1/2 its weight.<sup>12</sup>*

*D) Mexico, Indonesia, Nigeria, and Turkey with over \$3 trillion in GDP and 640 million people<sup>13</sup> are given less weight than Tencent, a Chinese tech company with \$28 billion in annual revenues and a \$540 market cap.<sup>14</sup>*

**Even if you believe in the potential of Chinese tech stocks, as I do, investors and clients should better understand the massive Asian technology exposure they are taking when investing in what they may believe is a more global and diversified Emerging Markets fund.** Standard and Poor's and FTSE also have created benchmarks for emerging markets which are similar to that of MSCI, with a few differences that make them a tad more representative, in my opinion. Conversely, if a client wants to invest heavily in Asian tech stocks, there are ways to invest more directly in these stocks and sectors.

**If the point of EM index and mutual fund investing is to diversify away single stock risk and approximate EM underlying growth, EM funds that are based on these benchmarks don't seem to fit this goal.** Financial advisors, robo-advisor programs, and retirement plan administrators should be aware of these discrepancies and inform and advise their clients accordingly. **Caveat emptor.**

**If you have received this email, we have met in person previously and you have given me your business card.** I was previously at Merrill Lynch, but have left to start my own wealth management firm Meta Point Advisors where I am able to write about such critical issues. I previously worked on Wall Street and in London and advised the world's top fund managers on their investments in emerging markets and the US. While at Harvard, I wrote a paper on women in business presented at the World Economic Forum and, previously, on artificial intelligence for DARPA program managers. My investment talks to Harvard alumni have been well-received and I'd like to bring my insights to a larger audience.

I hope you take the time to read my new white paper on Misleading Emerging Markets at <http://www.metapointadvisors.com/> and my \$4 Trillion Bond Fund paper which I hope will shed light on the true risks in your underlying investments. In today's world of robo-investing, over-diversification and group think, too few people seem to really understand what investments they really own. Please feel free to forward this along -- I would appreciate your feedback and referrals. I will be in Davos next week and available for an interview or to discuss.

Best regards,  
Maya



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*The opinions expressed are those of the author and not necessarily those of Lincoln Financial Advisors Corp. CRN-1996076-011618*

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