AJBell Investcentre

Fundamentals with Russ Mould

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Welcome to the latest edition of Fundamentals. This time around I'm going to look at a so-called passive fund, namely iShares Core MSCI Emerging Markets IMI ETF.

[CAPTION – iShares Core MSCI EM IMI UCITS ETF USD (Acc) GBP EPIC code – EMIM SEDOL – BKM4GZ6 ISIN – IE000BKM4GZ66]

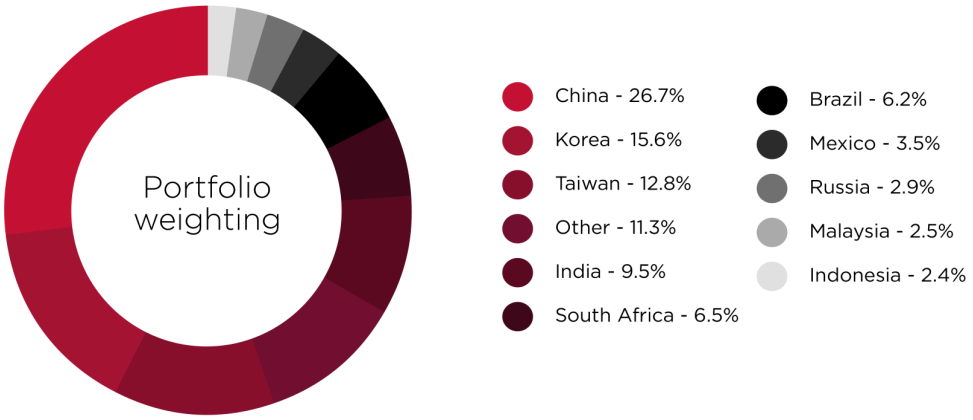
This is an Exchange-Traded Fund or ETF. It is designed to track the performance of the underlying assets and deliver that performance, minus any running costs.

In this case the ETF is tracking an index which has the specific name of MSCI Emerging Markets Investable Market Index – that's what the IMI in the name means. The benchmark covers large, mid and small caps across 23 countries and the tracker covers just over 1,900 of the near-2,600 firms within it and it targets stocks and markets which are liquid and investable and whose performance is easy to replicate.

iShares Core MSCI Emerging Markets IMI ETF uses physical – or direct – replication to generate performance so it owns the underlying securities.

The top five holdings as I sit here are Chinese internet phenomenon Tencent, Korean tech giant Samsung Electronics, Taiwanese silicon chip maker TSMC, Alibaba, another Chinese internet play, and South African internet and media group Naspers.

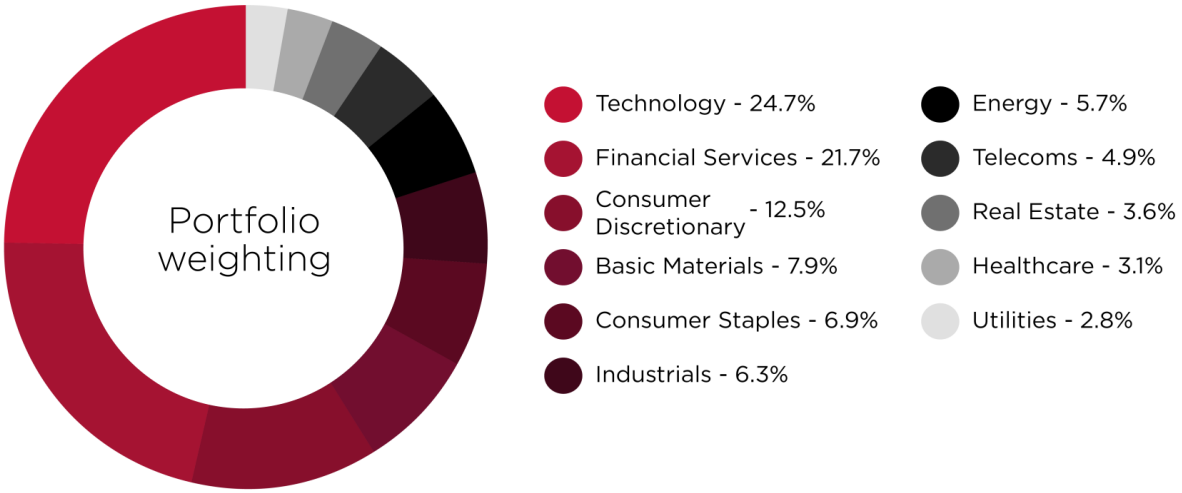
By country, China is the largest exposure, at 26.7% of the portfolio, followed by Korea, Taiwan, India and South Africa – they come to about 70% of the assets between them, as we can see here:



Source: iShares fact sheet, Morningstar

Note that after the June MSCI index review that weighting toward China is going to creep up a little, owing to the decision to include domestically-quoted A shares and not just Hong-Kong or US-listed Chinese equities.

By sector, as you have probably already guessed, technology is the biggest weighting at just under a quarter of the assets, followed by financial services and consumer discretionary. Utilities, healthcare and telecoms are the three smallest sector positions, so the underlying portfolio is better suited to growth oriented investors rather than those looking for yield or defensive, steady stocks.



Source: iShares fact sheet, Morningstar

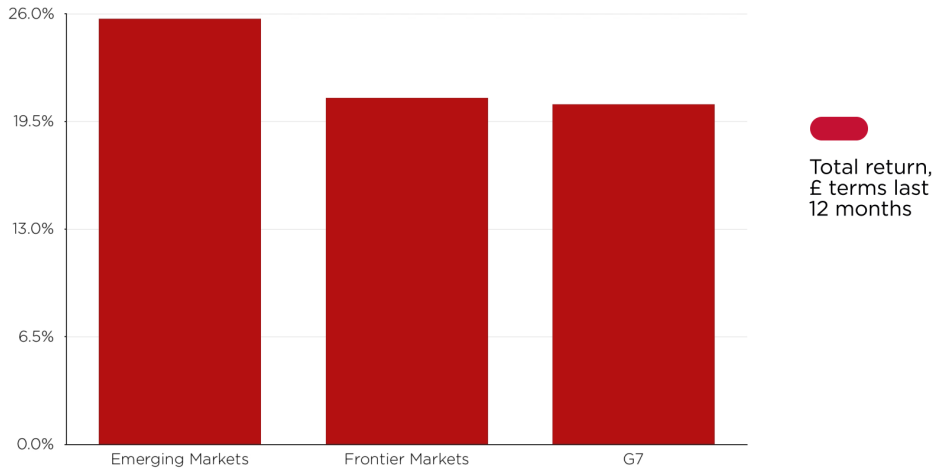
The tracker comes with an ongoing charge figure of just 0.25% a year so it is very cost-effective – according to data from Morningstar only two trackers out of a field of 47 are cheaper.

The iShares product has around £4.7 billion in assets under administration, so it should be pretty liquid, at least under normal market conditions. This particular instrument comes with accumulation units, so anyone buying will have any dividend payments automatically reinvested for them, and this is the dollar-priced option. Advisers and clients can buy a version of the ETF which comes priced in pounds.

The tracker is just over three years old and comes with a three-star ranking from Morningstar, for those who place importance in such things.

Those are the mechanics so the next question is why would advisers and clients consider this ETF for their portfolio today? I think there are three factors to consider:

- First, some may fancy looking beyond the UK, given the uncertainty over Brexit, the volatile political situation and the sluggish economic growth which the UK is currently struggling to offer.
- Second, emerging markets are doing well. They were out of fashion for a big part of this decade but have roared back in the last 12 to 18 months. Countries have less debt than we have in the West, economic growth is quicker than we are generating here and companies are becoming more shareholder aware. The chart here shows how the MSCI Emerging Market equity index has beaten its Frontier and G7 equivalents over the past year, in sterling terms.



Source: Thomson Reuters Datastream

- Third, Emerging Markets offer exposure to sectors which are harder to access via the UK or some other markets. If you like the growth potential offered by internet and tech stock, then Emerging Markets may be a better option than the UK or Europe, for example.

This final chart shows how the ETF has performed since launch but none of this is to say this ETF would necessarily suit everyone, as there are at least three clear risks:

Source: Thomson Reuters Datastream

- First, as already flagged, this is not a product that is likely to appeal to income-seekers or risk-averse investors. Remember the old joke that emerging markets are called emerging markets because they are very difficult to emerge from when something goes wrong.
- Second, having primed its economy with fiscal and monetary stimulus last year China is currently tightening policy so its own property market and economy do not boil over. Any big slowdown in China would be potentially a big problem for a quarter of the underlying stocks tracked by this ETF.
- Third, tech stocks have been flavour of the months for a long time now. As a result the valuations attached to some internet stocks are now racy and there is little margin for error if anything goes wrong – note how some of the big US names have just wobbled a little of late and this may help to explain why Asian stocks have actually just hit a bump, stumbling to a five-week low.

In summary, advisers and clients need to do their research so they can judge whether iShares Core MSCI Emerging Markets IMI ETF ultimately fits with their own specific strategy, target returns, time horizon and appetite for risk.

Thank you for watching and I look forward to seeing you next time.

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