Emerging Markets Redefined: The Rise of the Dragon[1]

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China's announced Belt and Road Initiative (BRI), sometimes referred to as the New Silk Route (NSR), to allegedly aimed at boosting trade, capital investment and services between China and 65 other countries collectively accounting for a third of the world's GDP and investment estimates surpassing USD 1.7 trillion a year through 2030. The anticipated investment shall be directed to building the infrastructure towards connectivity through (i) land-based Silk Road Economic Belt (SREB) and (ii) the Maritime Silk Road (MSR). As such the 'Silk Road Fund' and the 'New Development Bank' have already committed USD 1.1 trillion. The anticipated developed corridors, both land and ocean-based, signifies the virtual regeneration of the historical 'Silk Road' connecting China, India, Persia, Arabia, all the way to Ancient Rome-Constantinople, (Modern Turkey) trading Silk, among other goods, and beyond, connecting civilizations in philosophy, religion, architecture, music and art. Furthermore, the underlying countries where either of the two routes link have simultaneously began a series of bilateral economic ties. The apparent collaborations, joint committees, investment commitments and trade arrangements were further strengthened as a result of historical ties and mutual economic interests. The question, therefore, becomes, could these geo-political and economic trends, evolving over the past five years, have direct implications on the global investor especially in its definition of 'emerging market' allocation?

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Are BRICS Falling?

The review of the notable BRICS is undertaken after almost a decade of its official recognition by the respective governments and attention from the investing public as a valid proxy for emerging market allocation. Considerable research has since been drawn towards the benefits of the globally recognized association and its economic/financial effects on the respective countries. The general consensus from the original BRICS association is appearing to have highlighted the benefit bias towards China and India and much less with Brazil and Russia. Although the perceived similarity of the stage in economic advancement was the original justification, the grouping was, and still is, questioned describing the BRICS as a 'loose club' and 'time for a rethink'. As the group members do not share economic motivations, nor do they share political, cultural, and historical affiliations amongst them, conflicting views have emerged towards the political and economic significance of BRICS. Furthermore, a major BRIC fund has witnessed a 69% decline over the past five years in indicating significant redemption while non-BRIC emerging market funds witnessed double digit growth rates. The aftermath of the global financial crisis and the respective BRICS performance have put investors in a bewildering position when identifying the proper emerging market allocation. This is reflected in the rise of the traditional broad-based emerging market indicators that seems to maintain until ambiguity subdues.

As such, an impartial assessment of economic and financial trends is required. Subsequently, it is argued that if structural shifts of capital flows is anticipated, one needs to capture the formalization of imminent economic blocs and deploy appropriate investment strategies. Resembling the 'BRI' or 'Silk Road' nations could partially serve strategic global portfolio allocations and allow potential long-term effects to translate in its risk/return characteristics. Although the BRIC acronym was coined in 2001, the official summit between the governments reinforcing the reference took place eight years later. Conversely, it is arguably suggested that the 'Silk Road' nations could possess a plausible justification to be tracked and possibly invested in as a cohesive economic bloc. The nations have demonstrated commitments as reflected in multiple fronts postulating the reference of 'Silk Road nations' as a result of the events rather than the cause.

Selecting 'Silk Road' Markets

In order to resemble the 'Silk Road' nations, it is crucial that a methodological approach is undertaken to allow systematic tracking and monitoring of the portfolio. First, the selection should stem from the BRI's recently announced routes and inquire on the contributing/beneficiary nations. Second, the primary set of nations should reflect nations with existing investment accessibility as emerging markets for the global portfolio. Hence, the existence of tradable indices listed in developed markets is the second pre-requisite. Third, to ensure cohesiveness, evidence must be presented on the growing endogenous cross-trades between the selected nations. Lastly, a set of conditions must be placed to allow the additions/deletions of markets to this investment basket.

Starting from the BRICS nations as the first wave, China, India and Russia apparently partake a direct link and meet the abovementioned conditions in various degrees. The second wave of nations meeting the abovementioned conditions are Indonesia, Malaysia, the GCC and Turkey. All four markets are (i) directly linked to one of the main Silk routes, (ii) represented by ETFs listed in developed markets (U.S., U.K. and Europe) with significant assets under management and (iii) significant bilateral growth is witnessed over the past five years in terms of trade and investment. The GCC, although a block of six nations, is often looked at as one from an investment perspective. The third wave of nations believed to constitute the watch list for potential addition are Egypt, Pakistan, Kazakhstan, Iran, Mongolia, Nepal, Sri Lanka and Greece. I shall place focus on the first two waves of markets and from now on forward shall be referred to in this study as 'SILK'.

Analysing economic trends starts with reviewing economic indicators of the mentioned countries. SILK countries, beyond China and India, have all witnessed double digit growth rates in GDP and standard of living, with the exception of the GCC. The GDP/capita of the GCC, Turkey and Malaysia surpass that of the BRICS. Furthermore, continuing to exclude China and India as common denominators of both BRICS and SILK, economic indicators can be viewed in their aggregate form. On one hand, Brazil, Russia, and South Africa (BRS) and on the other, Indonesia, Malaysia, Turkey and the GCC (SILK). Interestingly, both groups compare closely both in terms of aggregate GDP and in population. Nonetheless, it is clearly evident that the SILK group does indeed outperform BRS in GDP growth, average GDP/Capita, aggregate FDI, average percentage of Export to GDP and market capitalization growth. The results of this preliminary set of indicators place obvious justification towards the attention paid to the respective frontier markets in addition to reinforcing the long-term economic prospects foreseen by analysts.

Exhibit 1: Economic Indicators of Emerging Economies

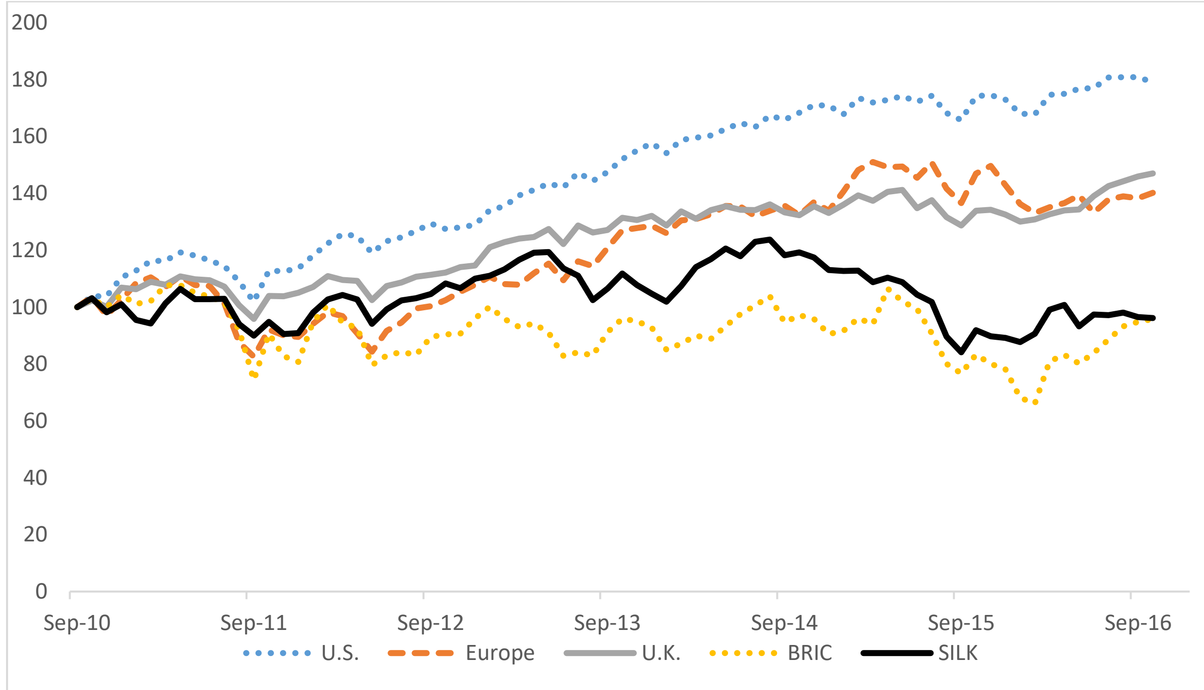
	China	India	Russia	SA	Brazil	Indonesia
GDP (*bn USD*)	11199	2264	1283	295	1796	932
GDP Growth (*%*)	84	37	-16	-21	-19	23
GDP/Capita (*USD*)	8123	1709	8748	5274	8650	3570
GDP/Capita Growth (*%*)	78	27	-18	-28	-23	15
Export (*% of GDP*)	20	19	26	30	12	19
Inflation (%)	1.4	4.9	15.5	4.6	9.0	6.4
Population (*mn*)	1379	1324	147	56	208	261
Market Cap. (*bn USD*)	7321	1567	622	951	759	426
Market Cap Growth (*%*)	82	-4	-35	3	-51	18
FDI (*bn USD*)	242	44	7	2	75	20
Start a Business (*days*)	29	26	10	43	80	25

	Malaysia	Turkey	GCC		BRS	SILK
GDP (*bn USD*)	296	858	1370		3374	3456
GDP Growth (*%*)	16	11	21		-19	18
GDP/Capita (*USD*)	9503	10788	30721		7557	13645
GDP/Capita Growth (*%*)	5	1	-9		-23	3
Export (*% of GDP*)	67	22	63		23	43
Inflation (%)	2.1	7.7	1.9		9.7	4.5
Population (*mn*)	31	80	54		411	426
Market Cap. (*bn USD*)	360	172	910		2332	1868
Market Cap Growth (*%*)	-12	-43	27		-28	-3
FDI (*bn USD*)	11	18	14		83	62
Start a Business (*days*)	19	7	15		44	16

Source: World Bank

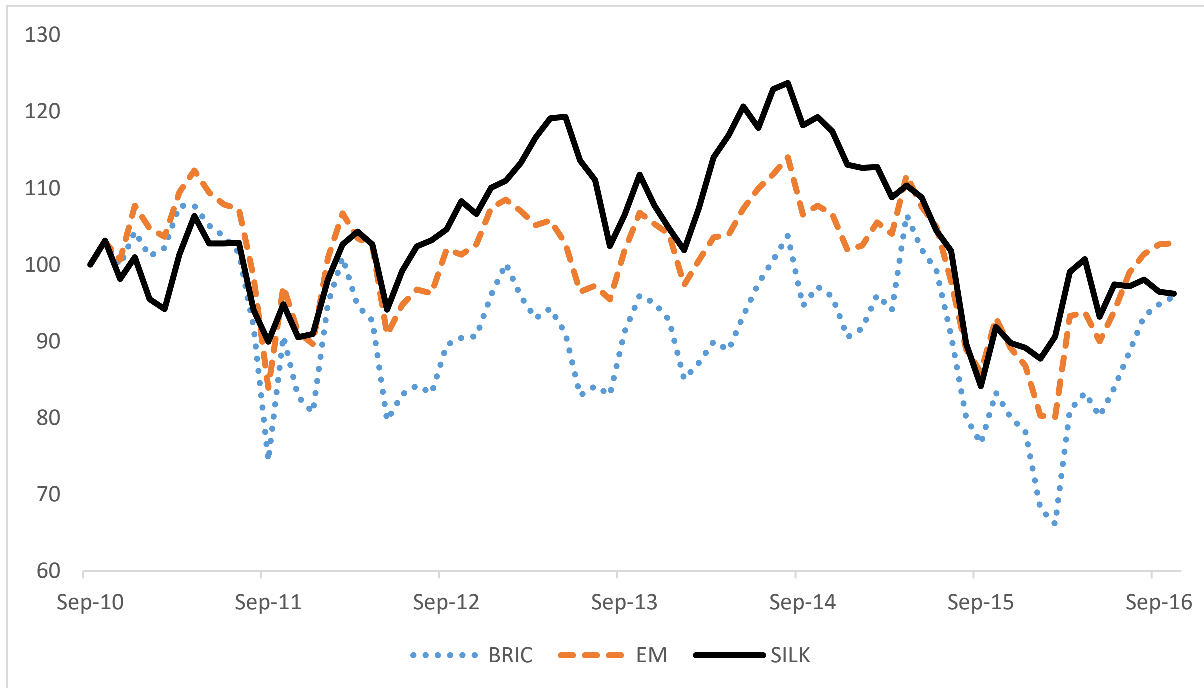
The investor perception is further reflected in the 209% increase of the broad emerging markets ETF. Although limitation exists from the mentioned results as ETF assets under management presented is not exhaustive, the figures are representative of investor dynamics with respect to emerging markets.

Exhibit 2: Performance of Global Portfolio Variables (rebased at 100)



Sources: Reuters, Blackrock.

Exhibit 3: Performance of Emerging Market Indicators (rebased at 100)



Sources: Reuters, Blackrock.

When testing portfolio diversification, 90% of portfolios incorporating SILK produced effective diversification when opposite positions are taken. SILK portfolios produced more effective diversification with developed markets than BRIC (90% versus 75%).

Concluding Remarks

Motivated by socioeconomic indications signalling the drift of economic motivations and towards strategic cohesion for collaboration, it has arguably become clear that an alternative bloc reflecting the upcoming long-term trend is imminent. The grouping of SILK nations could indeed provoke controversial opinions within the investment community, and, therefore, must be noted that it is intended to set an example rather than a standard for future grouping of emerging and frontier markets. Perhaps we should re-examine our definitions of emerging market blocs. It may well be that BRICS could still maintain interest amongst the investing public and, therefore, there is no reason why future groups cannot be tracked and continuously benchmarked adjacently. However some clear evidence have emerged that postulate a plausible justification for considering alternative economics bloc in global asset allocation. Despite the eminent significance of China and India within any emerging market allocation, it is crucial that the investment community set solid strategic directions and place structured criteria on what is progressively growing in importance for future capital flows. Inevitably, industry participants are called upon to ignite independent set of measures in grouping and tracking markets of cohesion and potential. Accordingly, only time can become the proof of traction and investment demand as reflected by investors and conducted by active and passive fund managers.