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EMERGING MARKETS

Prudential Details EM Megatrends for Next Decade

The insurer's investment arm expects major growth for financial technology, infrastructure, and the middle class. Avoid passive investing.

By DIMITRA DEFOTIS

Emerging markets will be the investment growth vehicle for the next decade, and there are three themes to watch as a "radical shift" in wealth and trade gets underway.

That's according to PGIM, New Jersey–based insurance giant Prudential's portfolio management arm, which oversees $1 trillion in assets, including $67 billion in emerging market stocks, bonds, and real estate. The firm shared a recent 30-page white paper exclusively with Barron's.

The first theme PGIM cites is the jump into the digital age, which benefits companies selling financial technology. Another is modernization, leading to new infrastructure and real estate investments. And the final theme is the rising power of the urban middle class. Taimur Hyat, chief strategy officer at PGIM and the report's primary author, spoke with us about these themes last week.

Fast-moving technology is an immediate opportunity. In low-income economies, only one in 100 people age 15 or older has a credit card, but one in 10 has access to money via smartphone. This means "unbanked" people may leapfrog traditional banks. Investors should take heed because old-school financial companies make up a quarter of the iShares MSCI Emerging Markets exchange-traded fund (ticker: EEM). Better to look for mobile banking opportunities in these markets, particularly in less developed areas like sub-Saharan Africa. With the advent of electronic spending, retail e-commerce is taking off. In India, such sales are expected to triple to $47 billion by 2020.

BETTER TECHNOLOGY leads to a second PGIM theme, modernization—of infrastructure, real estate, and local bond markets. E-commerce, for instance, requires more warehouses and truck terminals. This is already being developed, with Alibaba Group Holding (BABA) investing in a Malaysian distribution hub. A new port designed to be a global logistics hub is in operation in Saudi Arabia. Infrastructure needs to go beyond that, to airports and railroads, improved water supplies, and expanded broadband access. In real estate, many Asian countries are adopting reforms to make it easier for foreigners to invest. In Vietnam, deregulation has attracted Asian operators of stores and malls, including Aeon (8267.Japan) and Lotte Shopping (023530.South Korea). When big foreign operators step in, it's a harbinger of improving conditions for institutional investors, Hyat says. In Mexico, which listed its first real estate investment trust in 2011, PGIM predicts expansion of the roughly $13 billion market, despite growing pains. All this development will require the support of local bond issuers.

Also fueling growth are people, the third theme, which remains the heartbeat of emerging market investing. One statistic sums it up: Spending by the emerging market middle class is expected to expand from less than half of global middle-class spending today to 70% by 2030. As this plays out, emerging market companies will increasingly be tapping other emerging market consumer markets, rather than relying on U.S. or European demand for exports.

To play developing-market growth, indexes aren't the way to go, PGIM says, even if investors still flock to passively indexed ETFs. Indexes overrepresent indebted countries, and sluggish sectors that are—or were—controlled by governments. For institutions, PGIM suggests a combination of private equity, private debt, real estate, stocks, and bonds. For smaller investors, a middle-of-the-road emerging market allocation should be about 13% of a portfolio.