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The Importance of Emerging Markets



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"Moving to Singapore or Dubai now is like moving to New York City in 1908."

- Jim Rogers, 2008

Not too long ago a news headline caught my attention as it proclaimed "Jim Rogers Is Moving to Singapore" after spending the last 30 years in the heart of New York City. Now, many people will go their entire life without knowing who Jim Rogers is, but as a financial professional I know enough about his background as a worldwide traveler and investor to consider this event significant. In 1970, he partnered with George Soros, another financial guru, to start an investment fund that went on to gain a reported 4,000% over the following 10 years¹. He has also logged over 200,000 miles driving through more than 100 countries to immerse himself in the financial systems and cultures of the world's fastest growing economies—those with developing or emerging markets.

Emerging market countries are generally those still undergoing the process of industrialization or embracing capitalism. For example, only 200 years ago there was an emerging country we are all familiar with—the United States. At the time, China and India represented the world's largest economies, and had for 18 centuries. Between the business done within its borders and the vast amounts of silk, porcelain, and tea being exported to Britain and India, China alone was producing over 30% of the world's gross-domestic product (GDP)². That all changed, however, when the Industrial Revolution got underway in Europe and spread to North America. In the Western hemisphere, machines like the steam engine and textile looms were invented and used to enhance productivity,

cutting down the time it took to bring goods to market. The Chinese were resistant to the influences of the Western world and benefited little from these developments. In contrast, the newly formed United States was an emerging country eagerly absorbing the advances taking place in agriculture, manufacturing, and transportation that would change the shape of the world. Today, the United States and European economies each produce four times the output of the next largest economy--China³. Just think of the wealth generating potential if only there had been an opportunity to invest in the growth of the economy of the United States during the 1800's.

As investors, we are always looking for opportunities like this, and that's the reason behind Jim Rogers' move. Singapore is close enough to China and other Asian markets to allow him to experience first-hand the future growth of the region. China is the foremost example of a rapidly growing, or emerging market. It has received plenty of media hype over the last 10 years, and rightfully so. In 2001, Beijing, the capital city of China, was selected to host the 2008 Summer Olympics. There has been a flurry of tourism and business activity in the region ever since. A number of my friends and clients have taken tours of Beijing, Shanghai, or even cruised the Yangtze River in the last few years. For some, it was their second or third trip.

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In addition to being an incredible experience, most have also commented on the cranes littering the skyline of major cities, which is evidence of the tremendous pace of growth that is occurring. Tourism and capitalism are alive and well in China.

The progress in China is very exciting, but this level of growth is not limited to Asian economies. India, Russia, Brazil, and a number of smaller countries are experiencing rapid changes in their economy as well. In fact, the current economic slowdown may have a limited effect on many of the emerging countries. According to the latest estimates from International Monetary Fund research, most developed countries are expected to grow their economies by 1-2% annually through 2009. By comparison, economies of China, India, Africa, and Russia should grow between 6-10% over the same period⁴.

These regions are attracting outside investment, benefiting from an immense labor pool, and becoming more aggressive at marketing their products around the world.

You may be surprised by the increasing influence emerging countries have on global business and tourism. Lenovo, the Chinese computer maker, bought out IBM's PC business in 2005 for \$11 billion. Brazil's Embraer is now the world's third largest aircraft manufacturer behind Boeing and Airbus. Russian oil company Lukoil has hundreds of gas stations here in the United States, spread throughout New Jersey and Pennsylvania. While we have had cellular service in the U.S. for over 30 years, China Mobile has amassed over 300 million subscribers in its 10-year existence—more than AT&T, T-Mobile, and Verizon combined⁵. In Dubai, crews are building a series of islands named "The Palm" and "The World," large enough to be viewed from space. As investors, we have the opportunity to participate in the growth

potential of these regions. In fact, for many investors it should be an integral part of a well diversified portfolio.

Stoker Ostler introduced clients to emerging market investments not long after the firm's inception over 10 years ago. We have helped clients evaluate the potential returns versus the possible risks. As you might expect, an investment in emerging markets has more risk compared to those in developed markets. The presence of a growing economy and profitable businesses does not always translate into stock market returns. There can be a number of challenges in emerging countries such as political instability, changing economic policies, and civil unrest. As with any great investment risk, however, there is the possibility for great reward.

World Economic Growth

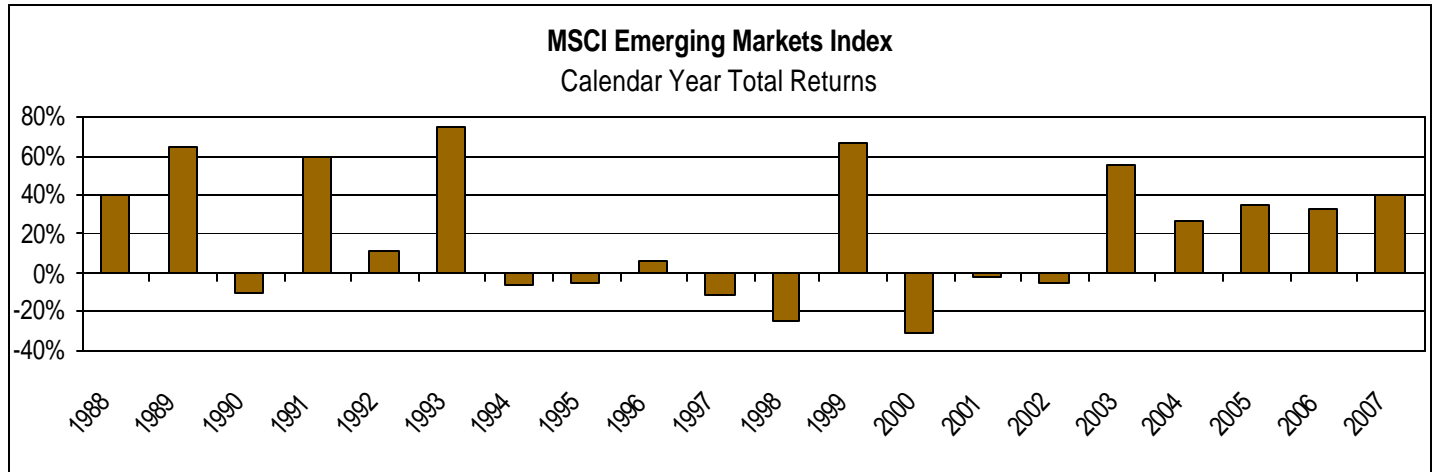
(annual percent change)

	2006	2007	2008*	2009*
World output	5.0	4.9	3.7	3.8
Advanced economies	3.0	2.7	1.3	1.3
United States	2.9	2.2	0.5	0.6
Euro area	2.8	2.6	1.4	1.2
Japan	2.4	2.1	1.4	1.5
United Kingdom	2.9	3.1	1.6	1.6
Canada	2.8	2.7	1.3	1.9
Emerging economies	7.8	7.9	6.7	6.6
Africa	5.9	6.2	6.3	6.4
Central and eastern Europe	6.6	5.8	4.4	4.3
Russia	7.4	8.1	6.8	6.3
China	11.1	11.4	9.3	9.5
India	9.7	9.2	7.9	8.0
Middle East	5.8	5.8	6.1	6.1
* projected				

Source: IMF, World Economic Outlook, April 2008

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In their short history, investments in emerging markets have developed an impressive track record, though the boom and bust cycles have made investment returns volatile at times. The MSCI Emerging Markets Index has averaged over 16% per year for the 20 years ending December 31, 2007⁶. As you can see in the chart above, the index has fallen as much as 31% in one year and gained 75% in another. It takes a steady hand and a strong stomach to stay the course with emerging market investments. They have weathered the Asian financial crisis, the Mexican Peso devaluation, and the collapse of Russian debt. For those who maintained the course, the long term rewards were well worth the risk. It is not for everyone; however, it is something that should be considered in a well-diversified portfolio. As with any investment, you should weigh the risks and rewards based upon your personal goals and with the help and guidance of your portfolio manager.

Sources

- 1 "Jim Rogers," Wikipedia.org
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- 3 International Monetary Fund, 2007
- 4 International Monetary Fund, World Economic Outlook, April 2008
- 5 "Emerging Giants," Business Week, July 31, 2006
- 6 MSCI (www.msci.com)



Satellite photo of Jumeirah Palm Island, Dubai



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