Investors Bet On Battered Markets

Some View Recent Dive in Developing Countries as Temporary and Excessive

Battered by the turmoil in emerging markets this year, some big-name investors say they are coming back for more.

Mark Mobius's Templeton Developing Markets Trust, which manages $2.1 billion, is down 8.6% this year after markets like India and Indonesia plummeted. Still, Mr. Mobius is holding on in these markets and has bought select stocks in Russia and Mexico.

At Pacific Investment Management Co., or Pimco, Michael Gomez is buying Brazil. And at Goldman Sachs Asset Management, emerging-market debt portfolio manager Yacov Arnopolin has snapped up Brazil's currency, the real, and the Mexican peso.

These investors, who together help manage $188 billion, say they are taking advantage of what they view as a temporary—and in some cases excessive—dive in developing-market stocks, bonds and currencies.

The selloff "is very much of a psychological thing that will pass once people come to their senses," said Mr. Mobius, executive chairman of Templeton Emerging Markets Group, which manages about $50 billion for Franklin Templeton Investments. "Our strategy is to take advantage of any downturns."

Emerging-market stocks have dropped 10.2% this year as of last Thursday, according to MSCI Inc., MSCI +0.86% while dollar-denominated government bonds are down 9.6%, according to J.P. Morgan Chase & Co. Of the 50 largest emerging-market stock and bond...
funds tracked by Morningstar, just two stock funds and no bond funds have seen gains in 2013. Investors have pulled money out of emerging-market debt funds for the past 15 consecutive weeks, according to EPFR Global.

The sea change these fund managers are awaiting may be approaching. Many emerging-market assets gained Friday after a report showed the U.S. economy created fewer jobs than expected in August, raising new doubts about the Federal Reserve's intentions to slow its bond-buying program. The Mexican peso and India's rupee jumped more than 1% against the dollar, while Brazil's benchmark stock index reached a three-month high.

Analysts say the exodus from developing economies this year has been sped by "investment tourists" who, having scoured markets for returns amid ultralow interest rates in the developed world, are bringing money home as economic prospects there improve.

The potential for improved growth in the U.S. has rallied stocks this year, and bets on the Fed winding down its bond purchases briefly sent Treasury yields above 3% last week, drawing back globe-trotting investors.

But the S&P 500 is off 2.7% from its early August record peak, and many investors believe Treasury yields are unlikely to rise much beyond 3% in the near term and could even fall barring drastic steps by the Fed to tighten monetary policy this month.

That leaves emerging markets. Developing economies are still growing faster than richer ones, and their currencies and bonds generally offer higher yields. If U.S. yields remain historically low, that could reignite the appetite for higher-yielding assets.

Even after this year's declines, emerging-market bond funds tracked by Morningstar have returned 6.6% over the past five years. Mr. Mobius's Templeton Developing Markets Trust is up 2.5% over that period.

The buying power of some of the biggest funds and their clients also could help lead to a recovery for emerging-market assets. Mom-and-pop investors are leaving emerging-
market funds, but investors with greater heft, such as pension and sovereign-wealth funds, are holding their ground, money managers say.

Investors can no longer assume every country will come out a winner, but few countries are veering toward a meltdown, said Mr. Gomez, co-head of emerging-markets portfolio management at Pimco, a unit of Allianz SE.

"The thing that surprised us a little bit was this narrative that [emerging markets are] facing this impending crisis," Mr. Gomez said. "There are some very big differences in emerging markets today than there were in crises of the past."

Indonesian brokers work at the Indonesia Stock Exchange in Jakarta earlier this month.

Pimco, which has $1.97 trillion under management, this quarter bought the Brazilian real and government bonds denominated in the currency, but exited bets on the Indian rupee about two months ago. Mr. Gomez said investors had punished Brazilian assets too much, while the country's central bank still has enough firepower to turn markets in its favor.

Not everyone sees a quick end to the tumult.

Jeff Kalinowski, portfolio specialist at T. Rowe Price Group Inc., TROW -0.31% which has $614 billion under management, reduced his holdings in Turkish bonds and completely exited positions in the Indian rupee after they dragged down the firm's Emerging Markets Bond Fund. The fund is down 10% this year as of Friday after four years of positive returns, according to Morningstar.

The Brazilian real has been one of the more painful bets, Mr. Kalinowski said. "We really want to like [the real]...but it keeps disappointing," he said. The real has fallen about 12.5% against the dollar this year as of last Friday.

Devan Kaloo, head of global emerging-market equities at Aberdeen Asset Management ADN.LN +1.56% PLC, which has $317.9 billion under management, said he added stocks in India, Indonesia, Brazil and other markets after they saw large declines. This quarter he bought shares in India's ICICI Bank Ltd., 532174.BY +4.93% which has dropped 15.7% in 2013 as of Friday. The Aberdeen Emerging Markets Fund is down about 10.7% so far this year as of Friday, according to Morningstar.

Mr. Kaloo said the selloff should force companies to cut costs and boost margins, now that they can't rely on steady inflows from foreign investors.
Goldman Sachs Asset Management, which manages $849 billion, is also bargain hunting, picking up Brazilian reais and Mexican pesos in late August, said the firm's Mr. Arnopolin.

"After a selloff of this magnitude you really start to say how much of the bad news is priced in? To us a lot of the risks are already reflected in the pricing," Mr. Arnopolin said. He said he is still betting against the Turkish lira and Indonesian rupiah.

But portfolio managers warn that it will take time for emerging markets to come back.

"It'll take longer than the end of the year to really to make up for the damage that's been done," said Steffen Reichold, an emerging-markets economist at Stone Harbor Investment Partners, which has $63.5 billion in assets under management. His firm bought the Mexican peso and Brazilian real in the past month.

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