



MONEY MORNING

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Four Unbeatable Emerging Market Stocks

As the U.S. economy sputters, emerging markets with more consumers, resources and growth potential are catching up fast. These four emerging market stocks are posting powerful profits on their way to becoming household names around the world.

If you're a global investor looking for global profits - including one potential way to double your money - you need to "Hit the BRICs."

Back in 2003, the Goldman Sachs Group Inc. - eager to push its clients toward emerging markets investment - created the acronym "BRIC" to stand for Brazil, Russia, India and China, the four emerging markets the investment bank's strategists believed would become a dominant part of the world economy in the years ahead.

What started as a marketing ploy is now a profit play that global investors have to consider, since at least three of the four countries - Brazil, China and India - feature sound economies with powerful growth rates, and stock markets with reasonable valuations.

In fact, China and India are two of the fastest-growing "investible" economies on the planet, and have been transformed into global leaders in both the manufacturing and service sectors. At the same time, Brazil and Russia each has become a cornucopia of commodities, and are emerging as global leaders in the white-hot global energy sector.

These newfound global strengths have provided all four of these countries access to massive amounts of capital, a key element of the investing methodology in both *Money Morning* and *The Money Map Report*.

With foreign reserves of \$1.68 trillion, China basically has all the capital it needs for the development projects it has on the drawing board. India has nearly \$300 billion in foreign capital invested in its stock market; and that virtually guarantees it will remain on global investors' radar screens for the foreseeable future.

After conducting this analysis, we decided to develop "**The BRIC Report**," a periodic feature

we'll use to update you on both the latest developments, and the latest profit plays, in each of the BRIC economies and BRIC stock markets.

Building Profits, BRIC by BRIC

While the BRIC countries are by no means the world's only attractive emerging markets – from time to time, in fact, the BRIC markets may become overpriced or their growth prospects may ebb – over the long haul, these markets remain strong opportunities for investors, and should remain at the top of your list of profit plays.

Here are the four top factors why this is true.

- **Population:** The four BRIC markets are the largest economies and have some of the largest populations among emerging-market countries (which don't include such already-emerged East Asian markets as Japan and South Korea). Companies from BRIC countries have large-and-competitive domestic markets, meaning they're already globally competitive when they venture abroad.
- **Rapid Growth:** China and India have two of the fastest growth rates in the world, and that looks likely to continue. Other rapidly growing countries are much smaller – and more risky.
- **Natural Resources:** While China and India are the major poles of global manufacturing and service growth, the two other BRICs – Brazil and Russia – are cornucopia of commodities and energy, which in the past have been inadequately exploited. The escalating energy and commodity prices of the last five years have brought rapid growth to both countries, enabling them to develop active consumer sectors with a multitude of investible companies.
- **Access to Capital:** Brazil recently achieved an investment grade debt rating from Standard and Poor's, giving the Latin American country access to the major global pools of institutional capital, while also significantly lowering the cost of its debt. Russia has built up foreign-exchange reserves of more than \$400 billion, allowing it to break free of a reliance on foreign capital. China, with a record \$1.68 trillion of foreign exchange reserves, has access to all the capital it can handle. Finally, India may finally have broken out of the cycle of foreign exchange constraints that had previously prevented rapid growth: With foreign capital of almost \$300 billion invested in its stock market, it is very much on investors' radar screens worldwide.

Let's take a look at the markets one at a time.

Bullish on Brazil

Having had its debt rating raised, Brazil is in the same position as an individual who gets a new job, pays off some debt and discovers the credit card companies suddenly all love him. It's a heady position, and highly profitable for Brazilian companies, provided the government doesn't go on a spending binge.

When Brazil was included in the “BRIC” group in 2003, it didn’t deserve the distinction. Long-term growth since the 1970s had averaged less than 2% annually per capita, and the country had narrowly avoided bankruptcy in 2002. Long-term interest rates were above 20% – around 15% in real terms – which hardly encouraged companies to make capital spending commitments that could provide a badly needed boost to Brazil’s flagging economy.

Brazil got lucky. First, President Lula has been surprisingly moderate, perfectly willing to welcome foreign investment and not at all like his socialist neighbor, Venezuelan President Hugo Chavez. Probably more important, it was in 2003 that energy and commodity prices began the long climb that has brought them to their current astronomical levels. Since Brazil was not an oil exporter, there was no one single source of new wealth that the government could seize. Instead, revenue flowed to mining companies, the oil company **Petroleo Brasileiro SA** (usually referred to as just **Petrobras**) and numerous agri-business operations.

Most startlingly, Brazil’s ethanol program, which had been a hopeless boondoggle for a generation since it started during the oil crisis of 1979-82, suddenly became the envy of the world. Rising oil prices made Brazilian sugarcane the world’s cheapest and most economically and ecologically efficient source of newly fashionable ethanol. Back when oil was trading at \$20 per barrel, the ethanol-from-sugar program was a typical example of misguided Third World government planning. But now that oil’s pushing \$130 a barrel, it’s a bonanza.

Brazil’s current growth rate is around 5% – but the Brazil of today is far more balanced and stable than in its 1970s version, even though growth back then was an impressive 10%. Brazil’s improving credit position is likely to allow today’s growth rate to persist. Besides, political risk appears minimal: When President Lula leaves office, a politician of the center-right could well replace him.

Another good sign for Brazil – there are more than 30 Brazilian companies with full American Depository Receipt (ADR) listings on the New York Stock Exchange, plus 40 or even 50 more traded on the over-the-counter market. Here are a few of the more-attractive examples you might want to consider:

Companhia Vale do Rio Doce, now referred to as **Vale**, is a huge iron-ore company with ancillary operations in gold, nickel, copper and other metals. At 10 times earnings, it is reasonably valued, though its dividend is only 1.6%.

The aforementioned **Petrobras**, which is one of the few emerging-market oil companies with access to modern technology and a willingness to work with the oil majors. But there are several negatives. First, even with a recent sell-off, the company’s shares are up substantially in the past year. The stock’s Price/Earnings ratio is a somewhat-steep 16, while its dividend yield is a modest 1.6%. But there is a possible upside here, should it find another gigantic offshore oilfield. The downside case: Oil drops back to \$50 a barrel.

Companhia de Saneamento Basico, or **Sabesp**, operates the water-and-sewage system for Brazil’s Sao Paulo region. Now *that’s* a growth business, and one that’s not dependent on commodity prices.

It has a P/E ratio of only 8.6.

Reticent About Russia

As long as world oil prices keep increasing, or at least remain high, Russian energy companies will keep generating record profits. If that happens, count on Russian consumers to keep enjoying the resultant bonanza, thanks to spin-off benefits that will boost consumer-sector profits (leading to the creation of products that consumers actually can buy). However, Russia is the least sound of the BRIC economies, and is the one that I would least like to be invested in over the long term.

Politically, Russia has pretty much reverted to the pre-1991 Soviet system.

Today, just like then, there's only one real party: The United Russia party, which controls 315 of the 450 seats in the Duma (essentially the lower house of parliament) and whose leader is one Vladimir Vladimirovich Putin. There is considerable censorship of the media, and dissident reporters and editors have a habit of disappearing - not that there are many left now. There is huge emphasis on military power, and on throwing Russia's weight around in foreign policy.

There is, however, a significant economic difference from the pre-1991 Soviet Union: While the state still controls most property, it does not control all of it as before.

Another difference: Before 1991, Politburo members were relatively impoverished and notorious for their lack of fashion sense and trademark baggy Soviet suits; these days the top brass, and especially Putin, are telegenic, snappy dressers with broad wardrobes of Italian clothes - and hefty bank accounts to match.

Economically, the Putin regime has produced huge economic growth - averaging nearly 10% per annum since 2000, including growth of 8.1% in 2007. A certain percentage of this was a "dead cat bounce" from Russia's debilitated state in 1998-99, while some was the effect of a Reaganesque tax reform passed in 2001, which produced a "flat tax" income tax system at a rate of 13%.

Since 2004, Russia's economic growth has been almost entirely driven by high oil prices. With Putin's partial seizure of the **Royal Dutch Shell PLC** concessions in 2006 and the **BP PLC** properties earlier this year, it's become obvious that the Russian state will control all economic activity in the energy sector. As a result, output has now stopped increasing; in the first quarter it actually declined slightly. New Russian President Dmitry Medvedev has announced an ambitious target of expanded output, but I remain skeptical that Russia will achieve this with its government-dominated economic system.

However, if you still find Russia alluring, you need to keep certain things in mind. Most important of all, remember that this is a highly speculative market, and you should be ready to sell if U.S. interest rates are raised, which could well signal that commodity and energy bubbles are up for a tumble. But since Russia is primarily a play on energy prices, two of the three suggestions are energy companies:

OAO Gazprom, the state-owned natural-gas monopoly, has ambitions to control Western Europe's gas supplies. Since its ambitions don't yet extend to the U.S. market, it is quoted only on the Pink Sheets. The shares are trading at 10 times trailing earnings, but gas prices and Gazprom's dominance are both rising.

Lukoil is the largest state-controlled oil company; but again, its shares only are available through the Pink Sheets. This one has a trailing P/E of only 6, based on 2007 earnings, but that was back when the average oil price was about \$80 a barrel. It's a good, but speculative, play on an additional run-up in oil prices, a trend that Investment Director Keith Fitz-Gerald has repeatedly predicted will continue.

Vimpel-Communications is a mobile telephone company with 55 million subscribers and mobile operations in Russia, Kazakhstan, Ukraine, Uzbekistan, Tajikistan, Georgia and Armenia. It trades at 14.3 times trailing earnings and has a decent dividend yield of 1.9%.

India Intrigue

Given that its stock market is down 23% this year, you're probably surprised to hear that India is my favorite of the BRIC economies. Even worse: India's torrid economic growth is throttling back a bit, and there are signs of a credit crunch.

But investors need to hear the proverbial "rest of the story." You see: If India had no problems, its stock market would be trading at 40 times earnings – and not 18 times earnings, as it is now. In other words, India could well represent a "double" for investors with the courage to buy in now and stay the course.

Without a doubt India remains one of the world's great long-term growth plays, and investors today are likely getting in on the ground floor of a major long-term bull market.

India's economic growth was 9% in 2007, and will be around 8% in 2008, so the overall market seems reasonably valued at the current multiple of 18. If India can get its political and economic houses in order, it has some very real prospects for a couple of generations of rapid growth before living standards start to approach the West and growth rates slow.

In the short-run, however, there are some potential pitfalls to be aware of. The current Indian government, in office since 2004, is a coalition between the Congress Party, which had ruled India for most of the period since independence without any great success, and the anti-market Communists. Although Prime Minister Manmohan Singh is a moderate, the government has seen India's economic emergence as an opportunity to fund favorite projects and social programs.

The budget for the current fiscal year (ending next March) proposes an 18% spending increase, and that's after spending rose 24% last year. The state budget deficit (federal plus local) is around 7% of gross domestic product; in any kind of recession, that could easily spike to the 10% of GDP level at which deficits become difficult to finance.

There is hope on the horizon: An election is due in May 2009, at latest, and the center-right opposition is currently leading in the opinion polls. But wise investors know better than to base their investment plan on something as uncertain as that.

India's other big problem is inflation, currently running at 8% per annum, which is higher than short-term interest rates. Higher commodity and energy prices have affected India as they have other countries; India's position is made more difficult by the poverty of much of the population.

The Indian government has restricted exports of rice and has subsidized other foods and gasoline (the latter makes no sense socially since automobiles are largely owned by the middle classes).

Needless to say, these subsidies and restrictions make the budget deficit worse, and will pose an additional problem when they are lifted and newly unfettered consumer prices soar in response.

Growth has now acquired huge momentum, and any conceivable Indian government will do no more than slow it temporarily. Furthermore, the economics of the contracted-out customer support and manufacturing services that India has built into a national mainstay – in the era of globalization and the Internet – is so compelling that it will inevitably continue to produce huge profits for decades to come. The question is not:

“Should I invest in India?” It's actually: “How can I afford to ignore India?”

And the answer is: You can't.

Stocks to consider would include **Infosys Technologies Ltd.**, the Bangalore-based software giant, which seems pretty invulnerable to Indian or global recession and is selling at a fairly reasonable 19 times current earnings and 20 times next year's earnings.

Another possibility is the pharmaceutical company **Dr. Reddy's Laboratories Ltd.**, a major generic drugs manufacturer that can expect to benefit from the expiration of many U.S. pharmaceutical patents in the next five years, and carries a fairly reasonable forward P/E ratio of 23.

Finally, you might consider India carmaker **Tata Motors Ltd.**, whose shares currently trade at about 8.5 times earnings. In the luxury end of the market, Tata recently bought Jaguar and Land Rover from Ford Motor Co. And at the bottom end, Tata has grabbed global headlines with its \$2,500 Nano, a car that's 40% cheaper than anything else on the world market.

Charged Up Over China

As we've pointed out repeatedly, China is a huge opportunity: It's already the third-largest economy in the world after the United States and Japan, and it quite possibly could be the world's largest by 2025. Its stated growth rate is even higher than India's, although Chinese economic statistics are pretty suspect. Nevertheless, apart from the qualms raised by the Chinese market's six-fold increase in 2006-07, and current high valuations, there are significant weaknesses that should not be ignored.

The two biggest: China's banking system and its high rate of inflation.

China's banks were for years used as a piggy bank for state-operated industries, many of them major money-losers and some that were technically bankrupt. Instead of the state recording budget deficits by subsidizing rubbish, the banks would lend the money to the bad companies, recording them as current loans. The result was a mountain of bad debt in the Chinese banking system. Back in May 2006, Ernst & Young estimated the bad debt had reached \$911 billion (an estimate Ernst and Young was forced to withdraw; after all, they do have a substantial auditing business in that country!).

Encouragingly, Chinese authorities are beginning to attack this problem: An estimated \$130 billion of the country's \$200 billion sovereign wealth fund has been used to recapitalize parts of the banking system. Since China has \$1.68 trillion of foreign exchange reserves, and the bad debts are presumably still only \$1 trillion or so, China does have the financial wherewithal to solve the problem. However, using FX reserves to recapitalize the banks would be highly inflationary, providing an almost 50% increase in the money supply.

That brings us to the next problem: Inflation, which is rising sharply. China's official inflation rate for the year ending in May is 8.3%, but the actual inflation rate is believed to be much higher.

China's yuan has been allowed to appreciate against the dollar to combat this, but the real need is for higher interest rates, which are still below the inflation rate. It seems inevitable that China will suffer some kind of tight money crisis, in which the banking system is recapitalized and inflation conquered, while the real economy suffers accordingly. However, such a crisis has appeared inevitable for several years now, and it hasn't happened yet.

Whether or not China suffers a short-term crunch, its long-term prospects are excellent. Its stock market remains highly illiquid, since much of the market capitalization represents state controlled companies, of which only a small portion are publicly traded. Given the problems in the banking system, financial services should be avoided, while P/E ratios in many other sectors are far above what would be considered appropriate in the West. Nevertheless, with the 30% fall in the Chinese market since last November, there are now some bargains to be found.

- **CNOOC Ltd.** – China's major international oil company, is selling at a P/E ratio of about 15. Most of its exploration activity is concentrated in China's offshore region, but it also has operations in Australia, Indonesia and Africa. CNOOC is central to China's search for oil resources, and critical to its future growth.
- **Yanzhou Coal Mining Co.** – China's largest coal miner, is rapidly ramping up production to meet soaring worldwide demand for coal: China alone is commissioning one new coal-fired power station per week. Selling at 17 times current earnings but only 12 times forward earnings, Yanzhou is benefiting from soaring coal prices, as well as rocketing demand.

Both CNOOC and Yanzhou are major, state-controlled behemoths. For a venture into China's true private sector, consider a look at a medium-sized company that is active in generic pharmaceuticals in

what is potentially a huge market in China for such products. That company is **Sincere Pharmaceutical Group**. Its shares are currently trading at about 15 times current earnings.

[Editor's Note: The "Super Crash" isn't coming... [it's already here](#). Combined, the swirling forces of inflation, the credit crunch, exploding trade deficit, and our stagnate economy will cost the average American \$85,000 dollars over the next 6 to 18 months. However, over 50,000 investors are already using Peter Schiff's unique strategy for profiting from the "Super Crash." And now – for the first time – you'll be able to join them *for free*. [Here's how.](#)]



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