

Chapter Five

Portfolio Investments in ESMs: Microanalysis

Summary

This chapter investigates the developments in portfolio investment theory by way of introduction to portfolio investment in ESMs. Theory predicts and evidence confirms the diversification gains of investing in ESMs. This helps in explaining the upsurges of portfolio capital flows to ESMs in the 1990s. In addition, by demonstrating the fundamentals of successful international portfolio diversification, it helps us understand the degree of ESMs integration into the international financial market and explain how the degree of volatility of the ESMs returns may hamper that integration.

This chapter is based on the discipline of Business Finance, and sets out to demonstrate the interlink age between studies in business finance and macroeconomic approaches to portfolio investment flows and economic growth. It is also a necessary background to understanding and analysing financial crises in Chapter Six.