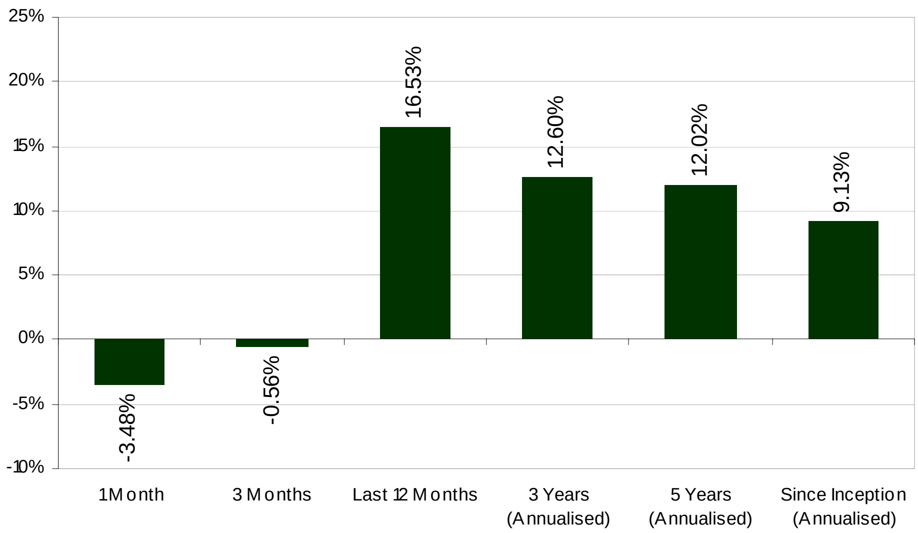
Returns worth celebrating, as emerging markets cash strategy turns one

September 2008 - Author: Lewis Jones, Research Analyst

Rexiter's synthetic cash strategy celebrates its successful one year track record and, despite a tough year for investing, impressive total returns.

The credit crunch, rising commodity prices, high inflation and perhaps even a new cold war… the past year has proven to be quite challenging for the investment world. Yet amongst the gloom, Rexiter's Global Emerging Markets Local Currency Cash Strategy, which has been managed on a synthetic basis for the last year, and its JPM Emerging Local Market Index Plus (ELMI+) benchmark, have managed to maintain attractive returns. Following the first anniversary of the strategy, which has outperformed the benchmark, we thought it fitting to mark the occasion by sharing with our readers some of the key themes over the year, and a reminder of the stunning characteristics and benefits of this exceptional asset class.

JP Morgan ELMI+ Performance

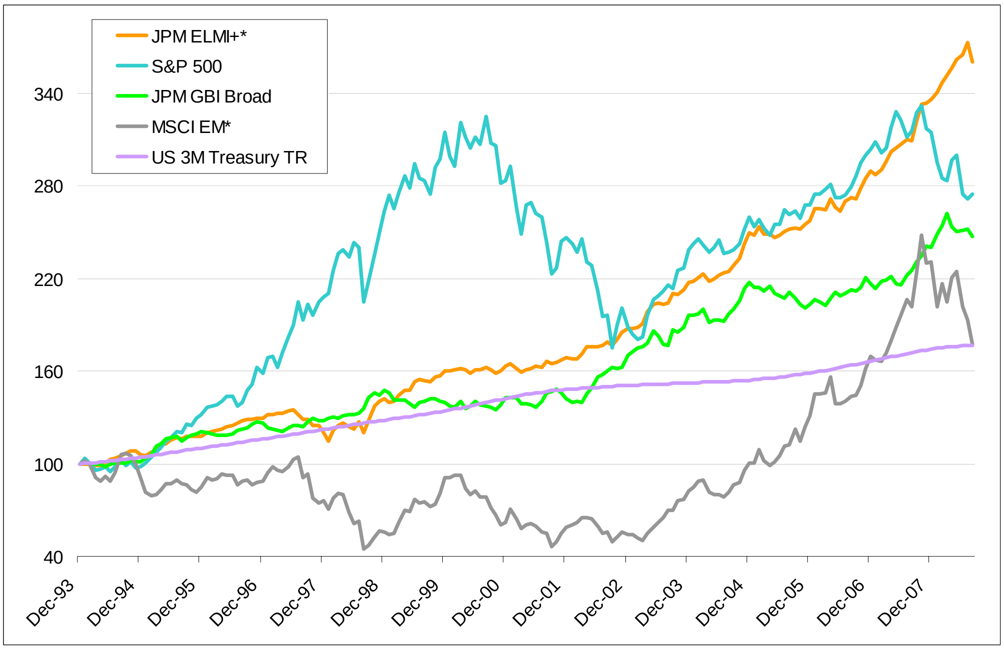


- 7.17% yield
- Approximate duration of 6 weeks
- 9.13% annualised return since inception
- 5.99% annualised volatility since inception
- 24 emerging markets

Benchmark Inception date: 31st December 1993
Source: JP Morgan, unhedged in USD.

This impressive performance is primarily due to the two main strengths of the asset class. Namely, the wide diversification across emerging markets and the attractive yields available in short rates relative to developed markets. The returns speak for themselves…

JP Morgan ELMI+ Performance Comparison



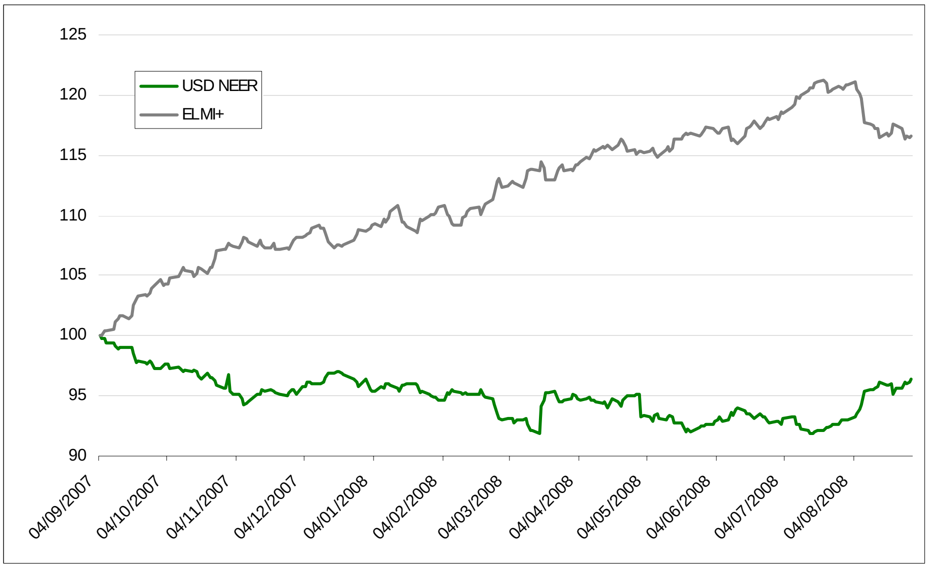
** Unhedged in USD   Source: JP Morgan, Bloomberg*

Key Investment Themes over the Year

A Period of Dollar Weakness

In August of last year, the credit crunch began to pinch and the knock-on effects to the wider global economy were starting to be felt. In response, the US Federal Reserve began slashing interest rates; 50bp in September 2007, followed by 25bp or 50bp in each subsequent month through to April of this year. This led investors to sell dollars and other dollar denominated assets, causing the currency to depreciate against most other currencies world wide. This move can be seen in the US dollar's Nominal Effective Exchange Rate (or NEER) which is measured on a basket of trade-weighted currencies.

JP Morgan ELMI+ vs EUR (31-Aug-07 to 29-Aug-08)



Unhedged in USD Source: JP Morgan, Bloomberg

As one would expect, the ELMI+ Index benefited from this depreciation, with performance rising over 20% through to the end of June 2008 (for a more detailed discussion of this relationship, please refer to our website article 'Emerging Markets Cash - What happens when the dollar turns?', which can be found at www.rexiter.com).

Followed by a Period of Dollar Strength

More recently, as European and other developed markets have also shown signs of a sharp slowdown, it looks increasingly likely that authorities and investors have switched their attention from concerns over inflation to concerns over low (or negative) economic growth. Ultimately, we are likely to see other central banks starting to cut rates, in particular the European Central Bank (ECB). This potential narrowing of relative interest rates, coupled with the falling price of oil, has led the US dollar to rally against some other currencies; especially in Europe and Latin America. Although all of this has translated to weakness in the emerging markets cash asset class, we expect losses to be short lived.

Active Management of Emerging Market Cash

Over the strategy's first year, we have had a period of dollar weakness, followed by dollar strength, and some very challenging market conditions. However, we have taken advantage of currencies and regions where movements in the dollar have some beneficial effects on fundamentals, such as in Asia. Rexiter strongly believes that emerging market cash should be actively managed, and looks forward to the challenges of its second year.