REXITER

Global Emerging Markets – Local Currency Debt

Monthly commentary

February, 2011

Market review

Despite the continuing protests in the Middle East and North Africa (MENA), local emerging market bonds remained firm over February. The JP Morgan GBI-EM Global Diversified index returned 1.49% in US dollar unhedged terms. It would have been very difficult to imagine beforehand the extent and pace of change we have witnessed in North Africa and the outcome of the protest is clearly very hard to predict. Rexiter is watching the situation very closely due to the effect and sensitivities this has on the wider emerging markets universe, and in particular commodities pricing. Remarkably all regional returns remained positive over the month, even MENA. Given the extent of the protests, change and uncertainty for Egypt, we think it would be no surprise to our readers that the return from Egypt was negative over the month. However, Egypt fell only 4.7% in February, which we think is light given the extent of the circumstances. Emerging market investors will be pleased that they were more than compensated from returns in commodity producing countries, such as Russia.

Market outlook

The developments in the Middle East and North Africa will keep market participants wary of taking substantial risks. Indeed, the price of oil has already factored a large premium due to the risk that the troubles in Libya will lead to all-out civil conflict. The protests in Saudi Arabia are also a matter of concern should they worsen. While we don't believe either of these events likely to occur they are still a possibility, so risk aversion will be the predominant factor until there is some clarity.

Inflation in many of the emerging markets remains a focus. Speaking generally, central banks are already tightening policy and we expect them to continue to do so until at least the middle of the year. As usual, this general outlook however has risen from our underlying view for each of our markets.

Strategy

In Latin America, the strategy remains overweight in Mexico and Brazil. However, we believe that the pace and magnitude of the appreciation in the Brazilian real is over done, so we are short the unit in currency forward space. There are rumours circulating the market that officials may extend the 2% IOF tax on equities to 6%, in line with the tax on fixed income investments, which would be negative for capital flows and the currency. For now, we are maintaining the short currency overlay position. In Europe, we continue to look for increasing our underweight position in Hungary to zero weight. In North Africa, we still have zero exposure to Egypt and, due to the fragile situation in the region, are unlikely to invest in the near term. In Asia, we are monitoring the situation in Japan following the devastating earthquake, tsunami and resulting damage to a nuclear power situation. It is yet too early to make a fundamental assessment on the effects this will have for the region and individual countries. However, the wider implication is that the situation will likely slow the recovery in global growth and increase investor risk aversion, on most investor's current central case. Slower growth could also have positive implications for global inflation. At the time of writing, emerging Asian bonds and currencies remain stable.