



Emerging Market Local Currency Debt

Monthly commentary

November, 2011

Market review

November brought yet another turn in the direction of performance for emerging markets local currency debt, with a down month following October's recovery. With the exception of Peru, all countries within JP Morgan's GBI EM Global Diversified index suffered losses over the month. The three month return is -8.04% although the 1 year return for the index remains positive at 2.84%. Despite the near term volatility in monthly returns, Rexiter's strategy continues to add positively to performance, highlighting the non-directional dependency of its underlying positioning. Yet again this month the individual performance of country returns are widely dispersed due to the large amount of risk aversion that overshadows markets, with the European debt sustainability concerns. We reiterate our position that there are large amounts of implementation risk for any solutions presented by European policy makers.

Although almost all countries posted negative performance, it was the difference between the regional returns that was most startling. With the well publicised problems we have seen in Europe, this dragged central Europe lower the most, by region. Hungary, the most exposed emerging market to core-Europe, was the largest loser by country by falling over 7% over the month. This makes Hungary losses close to 20% over the last 3 months, which came mainly via the depreciation of the currency. The pace and the magnitude of the fall of the forint gave us some cause for concern that this move down may well be over done. Elsewhere, however, despite being fundamentally stronger, Latin America and Asia were pulled down in this sell off.

Market outlook

In the closing months of 2011, the market is waiting with baited breath over any news on the European debt situation. We will not achieve the returns we had expected for local currency debt for the year but we will likely achieve yet another year of positive returns for the asset class. We believe that emerging market countries will be priced on their own individual strengths and weaknesses. Market participants will keep a close watch on these large systemic events and will be the main backdrop for the scene going forward. From a regional perspective, we still continue to believe that fundamentals in Latin America and Asia versus Eastern Europe have the strongest case for prospective investment. The outlook remains, at best, uncertain at the moment.

With concerns over the external environment, we are starting to mark down our expectations for economic growth from Asian countries although we do still view future growth being still relatively strong. In a slowing global economy, the weaker Asian countries will be those with open exporting economies such as Thailand, Malaysia, Singapore and South Korea. Although Asia is slowly becoming less reliant on the external sector it cannot escape the negative effects from Europe. Countries that display stronger domestic consumption, such as Indonesia and the Philippines, are in a better position to weather these external forces. However we feel that much of this is in the price for Indonesia, so will be looking to reduce our exposures to the country in the near term. The likely recipient of capital will be the Philippines.



Strategy

Markets remain fragile and very sensitive to negative news coming from Europe. The asset class has posted weak overall performance recently, which has effectively reduced our expectations of a strongly positive return for the 2011 but we do still believe it will be positive. Most of the strong gains made by local emerging market debt in the first half of the year were removed in the last few months. Speaking from a broad strategic view, we view the central European states as being most vulnerable at the moment. We will continue to avoid these weak countries and tactically transact in their currencies, when we see opportunities. As mentioned last month, the market uncertainty and resulting volatility has caused the cost of dealing spreads to widen making it much cheaper to implement strategy with the use of currency forward positions. The currency overlay is where we believe we can be most nimble with the current market conditions.