



Global Emerging Markets

Monthly commentary

July, 2009

Market review

Markets continued to move ahead, fuelled by the steady stream of buying of emerging companies by investors from developed economies. The rise of 11.1% brings the return for the year to date to over 50%. \$36bn has flowed into emerging markets this year – split roughly equally between investment in long-only funds and ETFs. By comparison almost \$50bn has left developed markets (source EPFR Global). The only area not to see significant inflows was Eastern Europe but, perversely, Poland (+28.6%), Turkey (+20.8%) and Czech Republic (+19.4%) were three of the top four markets, along with Indonesia (+24.5%). Every single market except Morocco (-6.2%) exhibited positive returns, though those returns were fairly modest in Thailand (+3.9%), South Africa (+5.1%) and Russia (+7.8%).

Market outlook

“De-coupling is dead” was a familiar refrain from brokers, clients (and us) as emerging markets collapsed last Fall. Well, a comparison of returns from emerging markets and the S&P500 over either short or long periods suggests we were premature to write off that concept.

In 2007 the S&P was up 5.5%, emerging rose by 39.8%. In 2008, the S&P fell 37%, emerging fell 53.2%. YTD (to 7th August), the S&P is up 13.6%, emerging is up 53.4%. So, in the short term (i.e. since the start of 2007), emerging is unchanged, while the S&P is down almost 25%. Over the longer term (10 years) coincidentally the S&P is still down 25%. Emerging has almost exactly doubled during that time.

For now, we suspect further outperformance of emerging markets will happen only if risk aversion narrows further and markets everywhere rise. Without that leadership a period of consolidation is probably due. This does not change the longer term perspective – trend growth in emerging economies will remain strong and this will eventually be reflected in higher asset prices.

Strategy

On a country basis, we have closed our underweight in Mexico funded by existing cash and by reducing Malaysia and are now overweight the country. We have also reduced exposure to India following the markets strong post election rally. We still regard India as perhaps the best long term “story” of all emerging markets and we will be looking for buying opportunities to rebuild exposure before long. We continue to be overweight Russia, India and Thailand funded by China, Korea and South Africa.

We continue to maintain an overweight to the financials, energy (in particular exploration & production) and consumer discretionary sectors. We are underweight the consumer staples and the information technology sectors.

In keeping with our core philosophy, we are seeking to maintain a fully invested, fully diversified exposure to the asset class. This does not mean we are looking to take risk out of the strategy, rather that we are trying to diversify that risk by country and sector.