



Global Emerging Markets

Monthly commentary

July, 2011

Market review

July was the calm before the August storm. The MSCI EM fell by just 0.38%. Most markets actually fell more than that average – declines of 3 or 4% were quite common, but the average was boosted by positive returns from Thailand (+11.6%), Peru (+8.4%) and Indonesia (+7.3%).

Market outlook

When looking at the problems of developed economies the only thing that we can be sure of now is that there is no magic wand that can be waved to make the problems disappear – we are in for a prolonged period of uncertainty. For the time being the direction of emerging markets will be determined by developments in peripheral Europe and on Wall Street. For most of the last two years our central scenario has been that the West will “muddle through”, thus providing a background of low interest rates and low growth from developed economies. The risks of a worst case outcome – namely a second credit crunch, a double dip in the United States and the possible disintegration of the Euro have clearly risen.

We have not changed our medium-term view - we continue to expect solid growth in emerging economies, driven by China, and slower growth in the West. As before, we believe that the Chinese authorities will succeed in a “soft landing” of the economy (we define this as a higher than 7% GDP growth rate). Its worth noting that China is finding it tricky to slow an economy with a lot of growth momentum – any worry about a hard landing would likely see the authorities willing and able lift their foot off the brakes a little. Compare and contrast with the West, where growth is going through a soft patch *despite* extreme monetary stimulation such as the aforementioned Quantitative Easing programmes.

Given that outlook it is tempting to take advantage of recent declines to increase the risk profile of the strategy – if we are right about the durability of growth in emerging economies it is probably right to buy now. However, we have to acknowledge the growing risks of a much worse than expected outcome in developed economies. Emerging markets would not be insulated from such problems and history tells us that in the early stages of a crisis, risk assets such as emerging equities would perform badly. Overall therefore, we have decided to stick with our modest pro-growth tilt, but not to increase it.

Strategy

Following recent market volatility we will, at the margin, reduce exposure to the technology sector, with the funds being employed to add to hard-hit high conviction stocks in the consumer and commodity areas of the strategy. The strategy is overweight Russia and Argentina, funded by under weights in South Africa, Chile and Taiwan. There are more significant divergences at the sector level. The strategy is overweight the consumer discretionary sector and underweight consumer staples and energy.

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.