



## Global Emerging Markets

### Quarterly commentary

March, 2011

#### Market review

A schizophrenic quarter. The first 6 weeks saw good economic news (continued recovery in the United States and stability in the Euro-zone) but falling markets. The second six week saw multiple economic and political upheavals, especially in Libya and Japan. Somewhat perversely markets reversed all their losses during this time to end the quarter at their high with a modest overall 2% rise. The resilience of markets highlights again the power of cash – and low interest rates. Given events of the quarter it was more predictable that Egypt (-23%) proved the worst market – and that oil-rich Russia (+16%) was the best. Most of the larger markets were bunched closely in a range of gains between 3% and 7%. Only oil-poor Turkey and India fell outside that range.

#### Market outlook

The IMF's recent report highlights reasons to be cheerful in the medium term despite the plethora of bad news hitting the headlines now. They expect world GDP to grow by over 4% both this year and next, with emerging economies forecast to grow by 6.5% in both years. The background for equity markets is thus much the same as it has been for the last 18 months – stable growth, driven by the locomotives of China and other emerging economies combined with low interest rates due to the structural problems afflicting most developed nations. There is much that could go wrong with this benign foundation – a sustained oil price rise (as opposed to a temporary spike) is a classic tail event that is possible, but unlikely. We are not structuring the strategy for this. The market also worries about a hard landing in China. We do not believe this to be likely – the authorities have too many tools to manipulate their economy to lose control that badly. Of more concern to us is the possibility of a global upsurge in inflation. Most countries are enjoying trend or above trend growth combined with below normal interest rates and so much depends upon high unemployment to keep prices under control. For the time being markets seem content to relegate this obvious risk to the “not for next year” box. Careful management will be required to avoid the problem and not every economy will succeed.

#### Strategy

The strategy is overweight Russia and Turkey, funded by under weights in South Africa 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. Since the end of February the energy exposure has been increased at the expense of domestic stocks in Russia.

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.