



Global Emerging Markets

Monthly commentary

October, 2010

Market review

Maybe it is better to travel than to arrive? Markets reacted enthusiastically to the promise of a second round of quantitative easing but seemed to run out of steam a little in the run-up to the actual announcement. Emerging markets managed a further 2.9% rise, led by Peru which rose by 16% (there are only three stocks in the MSCI Peru benchmark – one a gold stock that rose 18% and another a copper stock up 22%). Most other markets rose very modestly with Eastern European markets generally leading the way.

Market outlook

Asset prices in emerging economies have clearly been buoyed by the flow of capital from developed markets, but it is obvious that these flows themselves cause major problems in economic management for the recipients. Brazil, South Africa, The Philippines and Thailand have all either raised barriers to entry of “hot money” or reduced the barriers to outward capital flows. More action from other emerging countries (Korea, or even China) is possible. These reactions are understandable and perhaps even inevitable. If successful, they could prevent an asset bubble forming, but capital controls are themselves difficult to manage and can cause other distortions. We remain of the opinion that the fundamental economic background in emerging economies is sound and that current valuations do not indicate a bubble has yet formed, but domestic fundamentals can be overwhelmed by exterior factors very quickly. This is a risky environment where big swings in asset prices (either way) could happen very easily.

Strategy

The strategy is overweight Russia and Turkey, funded by under weights in South Africa and Taiwan. We are increasing India to an overweight position – funded from Taiwan.

The strategy is overweight the consumer discretionary sector and underweight consumer staples.

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.