

Global economic power is shifting

absolute returns from emerging markets

Quarterly Update
October 2009

Emerging markets share as % of world total, end 2009 estimates



emerging market investment strategies

Overview

CAUTIOUS

“ As the developed world slowly emerges from recession it will take time for meaningful growth to kick in again. Therefore the majority of world GDP growth will come from emerging markets over the next few years. Given this we are bullish on emerging markets however surprises are likely to keep volatility prevalent. A looming concern will become when will stimulus packages be withdrawn? Given the amount of money governments have thrown at the crisis, we believe they are more likely to stay involved too long, rather than withdraw too soon. ”

Long Only Equity

BULLISH

“ The MSCI Emerging Market index remains some 35% below its highs however we believe that new highs can be touched going forward, given the growing strength of emerging markets and the companies within them. Huge reductions in the cost of credit and improving confidence should generate a further stimulus in 2010. Emerging markets are broadly undervalued versus developed markets. Furthermore emerging markets remain an underweight in most global portfolios. We think things will change as confidence grows. ”

Long Only Bond

CAUTIOUS

“ Emerging bonds have rallied significantly from their lows however they have still significantly underperformed emerging market equities on the rebound. However this has meant that bonds have also recovered all of the losses they suffered during the crisis which makes bonds relatively expensive. However given the trend going forward is likely to be interest rate rises this presents further challenges for returns available from this strategy. Such uncertainty is why we remain cautious on emerging bond strategies. ”

Long/Short

BEARISH

“ Most Long/Short strategies in emerging markets are struggling to deliver returns from the short side. This therefore produces uncertain returns which are likely to keep investors wary of such strategies in the foreseeable future. This combined with concerns about the industry, reduced leverage conditions and fund redemptions are causing some funds to close and others to modify structures. Given this uncertainty, until the dust settles on the challenges for long/short strategies in emerging markets, we remain bearish. ”

things to think about now in emerging markets

Emerging Market Growth

BULLISH

“ Emerging markets will account for over 75% of world GDP growth over the next two years. The IMF currently estimates the BRIC economies alone will contribute close to 70% of world GDP growth in 2010, while the USA will only contribute 5%. Mobile phone and internet connections are rapidly changing the way and ability many emerging economies are evolving. Consider emerging countries now have 3 billion more mobile phone users than developed countries. Furthermore China now has more people with internet connections than the entire population of the USA. ”

G20 Replaces G8

BULLISH

“ Shifts in economic power tend to be associated with disruptions in the world economy. This crisis has certainly allowed emerging markets to gain a further footing in the world economy. There has been a shift in economic power as the G20 replaces the G8 as the main global economic forum - a forum where emerging countries now outnumber developed countries. The shift to the G20 forum includes countries that are currently estimated to represent more than 90% of global GDP. ”

Shift Toward Domestic Demand

BULLISH

“ Given the recent fall-off in export demand this forced many emerging markets to provide stimulus to their own economies. We believe this shift will become established re-focusing many economies on domestic demand driven growth. Although average incomes may still be low in these economies, the middle classes are expanding rapidly, creating a vast new market. Over the next decade, almost a billion new consumers will evolve, as incomes rise above the threshold at which people generally begin to spend on non-essential goods. ”

Economic And Earnings Recovery

CAUTIOUS

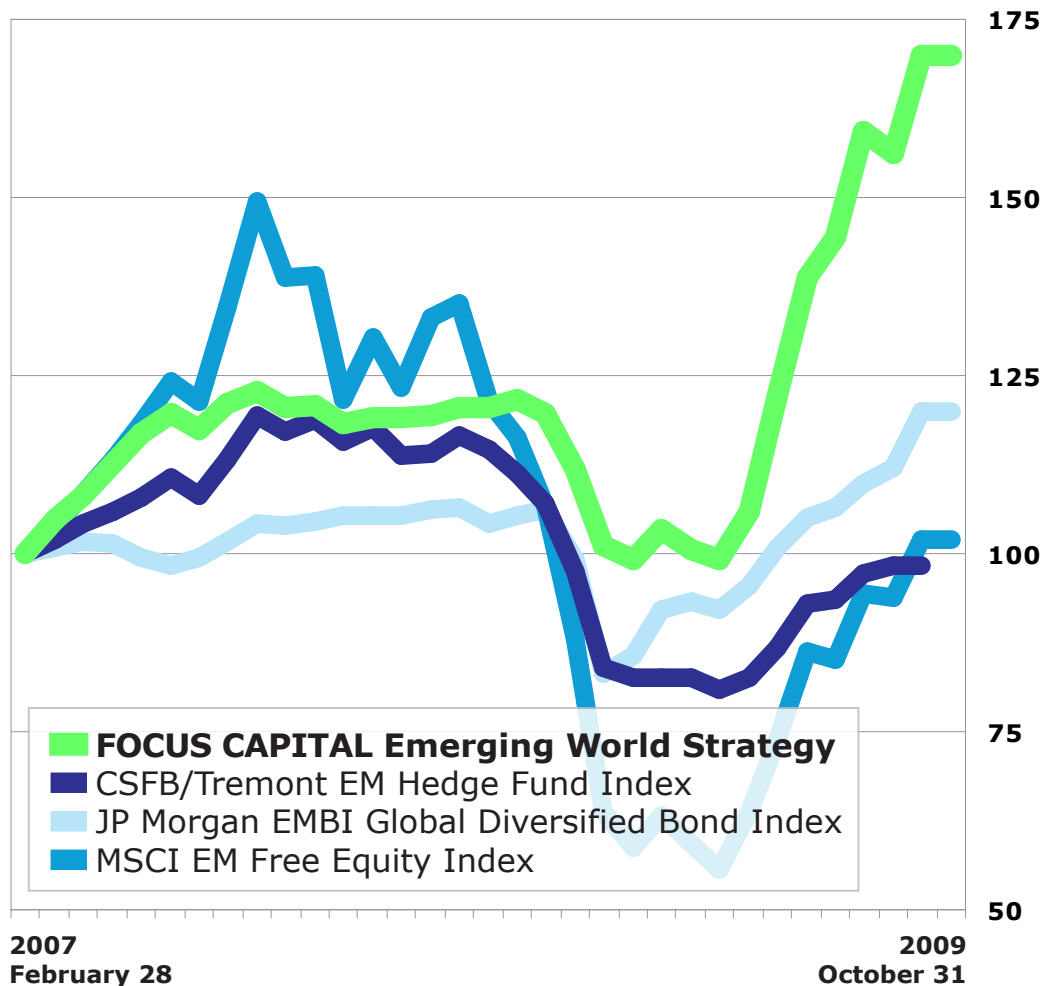
“ Markets became significantly undervalued in the recent crisis. But a synchronized global recovery is producing surprises to the upside in earnings. Low expectations are being surpassed and positive earnings revisions are likely to continue going forward. Key business surveys are also improving. A broad partial recovery has taken place in emerging markets and we expect earnings to become more important going forward. Such economic and earnings recoveries are likely to provide more discriminate outperformance from specific countries. ”



focuscapital

absolute returns from emerging markets

monthly performance



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