



NEWGATE *Market* MONITOR

Newgate's Emerging Markets Portfolio declined 10.1% in the second quarter and is down 8.6% for the year. The correction in emerging markets has been consistent with the pullback in other major market indices. Emerging markets have not given back their superior performance over the preceding 3 and 5 year trailing periods.

MARKET REVIEW. The global economy continues to recover, though at a slower pace than the equity markets had previously forecast. Policy makers in the developed world are debating whether austerity or greater fiscal stimulus is the appropriate response to the sluggish recovery. Ironically, European leaders advocate austerity as the US pushes for greater stimulus. The toxic combination of recession, credit crunch and sovereign debt concerns may result in a deflationary cycle in the developed world. Neither fiscal nor monetary policies appear to be reversing this process. These structural weaknesses do not exist in most emerging markets. As loose monetary policy in the developed world "leaks" into the emerging one, emerging markets central banks are forced to tighten monetary policy. It may well be that inflation is America's greatest export.

The Chinese economy has responded to government efforts designed to slow growth in the property sector. We believe that the naysayers on the Chinese economy are wrong; they are inappropriately extrapolating the debt issues of mature countries onto rapidly developing countries. That does not mean that the path for China (or any other emerging market) is without pitfalls and setbacks. However, we believe the degree of pessimism expressed is unwarranted. Despite the wave of negative headlines, the MSCI China Index outperformed the Emerging Markets Index, declining 4.5% vs. down 8.3%. The markets were initially buoyed then confused by the recent pronouncements regarding currency policy. Changes were announced intimating a managed float, rather than the peg currently in place. Yet the details and timing of any changes were left blank.

Commodity oriented countries like Brazil (down 15.2%), Russia (down 15.4%) and South Africa (down 9.5%) respond negatively to any sign of weakness in China. South Africa and Russia are two of the few emerging market countries that have cut interest rates recently, bucking the trend among most central banks to increase rates.

Korean stocks fell 7.6%. Political tensions with North Korea after the March 29th sinking of the ROKS Navy ship *Cheonan* dampened that market. South Korea's export oriented economy is also vulnerable to slowdowns in China and in Europe. Morgan Stanley Capital International (MSCI), which maintains the Emerging Markets and EAFE indices, decided not to remove Korea from the emerging markets benchmark at this time.

The Indian market fell 2.2% in the quarter, though it is up 2.5% year to date. The economy is growing faster than most expected, perhaps too fast, as inflation rose 10% even as food inflation moderated. Interest rates were increased 25 basis points in April, with forecasts for another tightening on or before the July central bank meeting. The government is moving forward with plans to divest interests in state held companies, with \$8.5 billion in new share issuance in this fiscal year alone and a total of \$36 billion shares to be sold over the next 3 years. This was the kind of action that had always been blocked during India's history of fractious coalition governments, but now seems more likely with the more unified government.

PORTFOLIO REVIEW. We maintained a substantial overallocation to China during the quarter, including positions in companies involved in gaming in Macau, which is becoming the Asian Las Vegas. We eliminated positions in the South African ETF to purchase gold and platinum companies in that country. Inflation has slowed, and the economy is recovering, though as in so many other countries the pace is modest and disappointing. During the quarter we added to domestically oriented stocks in Korea and reduced exposure to technology exporters.

Positions in Chinese telecom, energy and gaming stocks, South African miners and Taiwanese utilities were among the best performing stocks this quarter. Materials and energy in Brazil were the primary detractors.

OUTLOOK. Valuations in many emerging markets are now very attractive relative to historical norms as well as to developed market equities. Overall, emerging markets are trading at under 12x 2010 earnings. Korea, Turkey and Russia are trading under 9x earnings. Though changes in India are positive, at over 18x earnings we think there are better opportunities elsewhere. Investor psychology is very negative and risk aversion remains strong. Emerging markets offer value when investors decide to put risk back into their portfolios. ♦



EMERGING *Markets* PORTFOLIO

PERFORMANCE & RISK • 10/31/91 to 06/30/10

	<u>NEWGATE</u>	<u>MSCI EM INDEX</u>
Annualized Return	10.41	9.43
Standard Deviation	24.81	27.89
Beta	0.84	
R ²	90	
Alpha	2.50	

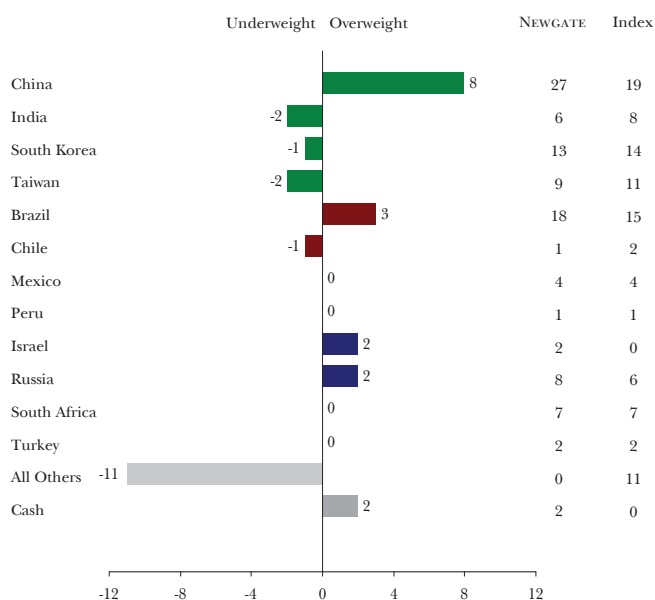
TOP TEN HOLDINGS

Global X China Financials	China	5.4
Vale	Brazil	4.3
Itau Unibanco Banco Multiplo	Brazil	3.5
Taiwan Semiconductor	Taiwan	3.3
China Life Insurance	China	3.2
Lukoil	Russia	2.9
America Movil	Mexico	2.9
POSCO	South Korea	2.7
Shinhan Financial Group	South Korea	2.5
Petrobras	Brazil	2.2

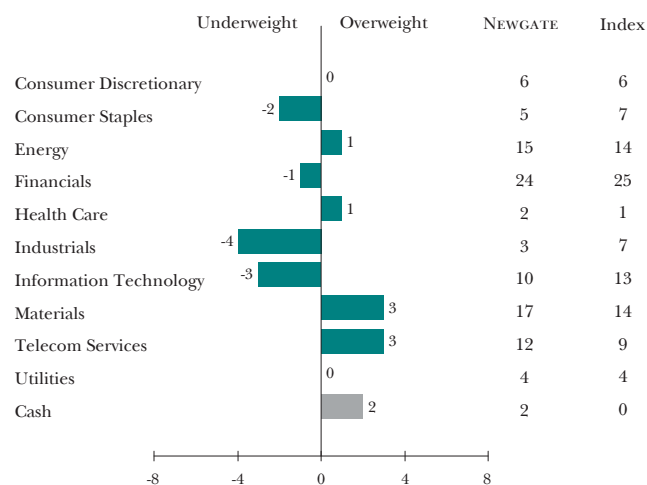
ANNUAL PERFORMANCE

	<u>NEWGATE</u>	<u>MSCI EM INDEX</u>
2Q10	-10.12	-8.29
YTD	-8.56	-6.04
1 Year	15.03	23.48
3 Year	-5.01	-2.22
5 Year	8.24	13.07
7 Year	14.34	18.74
10 Year	8.71	10.34
2009	60.57	79.02
2008	-51.25	-53.18
2007	36.15	39.78
2006	27.55	32.59
2005	27.19	34.54
2004	15.81	25.95
2003	60.45	56.28
2002	-8.06	-6.00
2001	-4.17	-2.37
2000	-12.06	-30.60

COUNTRY ALLOCATION



SECTOR ALLOCATION



M I N D I N G T H E F U T U R E T O D A Y SM

Past performance is no guarantee of future results. Performance may vary across accounts. Returns are calculated using a time-weighted market value assuming reinvestment of dividends. Performance is reported net of management fees, commissions, and other direct expenses, but before custody charges, withholding taxes, and other indirect expenses. Performance shown is compared to the MSCI Emerging Markets Index, a broad-based securities index that is unmanaged and not subject to fees and expenses. Investments cannot be made directly in a broad-based securities index. Any securities, sectors and markets listed are included for illustrative purposes at the time of publication and may not be held by accounts currently managed by Newgate. The securities identified do not represent all of the securities held in client accounts. It should not be assumed that any investments identified were or will be profitable. © 2010

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