



FLASH REPORT

Recent Market Correction

The global equity markets are in the midst of a correction. Sharp losses create the risk of panic selling by investors, in turn increasing volatility. Emerging market equities have declined approximately 15% since their peak. We wanted to share our thoughts with you regarding the recent market volatility and how it may affect Newgate Emerging Markets Portfolios.

Corrections happen in all markets and are in many instances healthy, as they take weaker participants out and set the stage for more strategic buyers to come in. There have been several corrections recently, including the 12% decline last spring and a larger, 20% decline in the summer of 2004. These recent corrections in an otherwise bull market have not been caused by systemic shocks.

Some have suggested that the current correction is a result of increasing inflation fears. While possible, we think that natural resource stocks, especially gold mining stocks, have led the recent decline. Gold itself has fallen over 10% from its peak. Declines in commodity prices and commodity stocks are inconsistent with a belief in inflation. These assets may have increased in price as investors anticipated inflation. However, we think the current correction is caused largely by profit-taking by some of the cross-over players (global hedge funds and global managers) seeking to lock in profits.

Valuations in emerging markets have become more attractive by this correction. The current Price-to-Earnings (P/E) ratio of Newgate's Portfolios is approximately 12.5, while the P/E of the MSCI Emerging Markets Index is approximately 15. The graph below shows historical valuations on the Index. P/E ratios have been in a modest range even during the unprecedented commodity bull market. This means that the earnings of companies have been more or less keeping pace with the equity prices.

As we wrote in the latest newsletter, the potential for economic and earnings growth in emerging markets has always been present. And over the past three years we have seen this potential realized. The market rally we have experienced since the fall of 2002 has been fundamentally driven by improving business conditions

in emerging markets, not by excessive speculation across the board.

Newgate is a relative value manager consistently looking to preserve capital, knowing that market volatility will occur. We are now realizing the positive results of our disciplined investment process. Our underweight to higher beta markets, most notably India, as well as the valuation criteria in our stock selection methodology, have historically provided our clients downside protection and continue to be the case thus far during the current correction. ♦

