



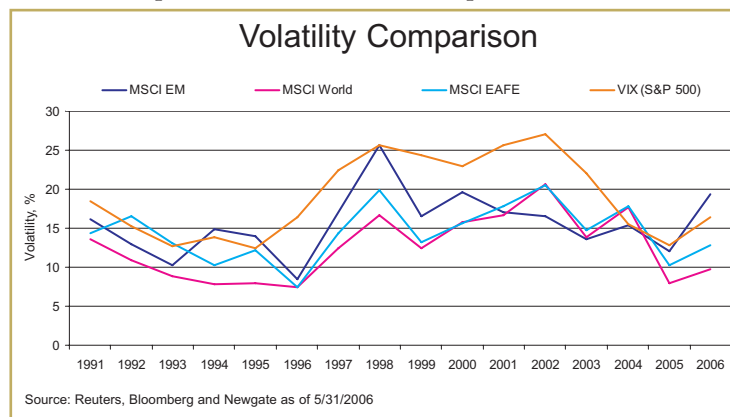
FLASH REPORT

Update: Recent Market Correction

Early June has seen a continuation of last month's correction in global equity markets. In less than a month, we have seen the major stock market averages retreat sharply. The S&P 500 index has fallen 5%, the MSCI EAFE index of developed international equities has fallen 12.7%, and the MSCI Emerging Markets Index has fallen almost 20%. There are two important considerations to keep in mind. First, this is the fourth correction we have experienced in the recent bull market in the asset class. Second, these corrections have occurred in an asset class that has increased over 225% since its most recent bottom in late 2002. It is only natural that there are some reversals as markets move higher.

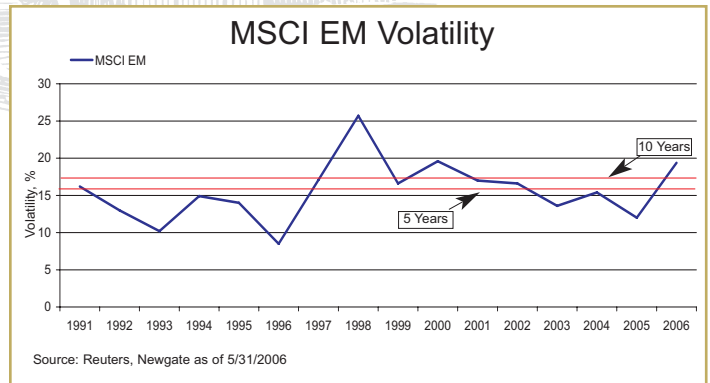
All equity markets are inherently volatile; emerging markets tend to have greater volatility than more developed markets. Investors accept this volatility due to higher expected returns and their imperfect correlation to developed world investments which provides diversification. For example, in more developed markets, a "correction" is typically defined as a fall of 10%, and these falls happen about every 2 years. For emerging markets, these fairly routine sell-offs have a magnitude of 15-20%.

The chart below shows the trend in volatility across the major equity asset classes for the past 15 years. The last several years have seen a marked decrease in volatility. It is notable that during the previous six years, the S&P 500 experienced significantly greater volatility than emerging markets equities. Only recently has volatility in emerging markets surpassed that of the developed world.



While the trend in the global equity markets is increased volatility, this is not necessarily a negative

development. The second graph shows how we are only slightly above the average level of volatility in emerging markets over the past 5 and 10 year periods. Instead of being in uncharted territory, this is a more normal period for emerging markets.



We believe it is important to reiterate that the current correction is driven by market anxiety, not poor fundamentals. Investor concern over the direction of interest rates, the price of oil, and the seemingly inescapable torrent of news related to geopolitical risks have led to profit taking and risk reduction from many portfolio managers. However, underpinning the markets is the fact that GDP growth remains strong across almost all countries and regions. Even the recently anemic markets of Europe and Japan are showing signs of sustained economic recovery. The market is concerned that growth may slow, but many markets, especially emerging markets, are growing at unsustainable rates. A modest slowdown in growth rates should actually prove beneficial.

Valuations continue to improve. The MSCI Emerging Markets Index is now trading just 14 times trailing earnings, compared to an average of 19. In contrast, the P/E ratio for the S&P 500 is 17. Furthermore, the strong economic growth in emerging markets means that projected P/E ratios in emerging markets are just over 10, while they are 14.5 for the S&P 500. Falling prices and some indiscriminant selling are creating opportunities for Newgate as long term investors in this challenging, but ultimately rewarding, asset class. ♦