



NEWGATE
CAPITAL MANAGEMENT LLC

June 2009

FLASH REPORT: EMERGING MARKETS

Portfolio Update

Emerging markets continue to generate positive returns with relatively little support from developed markets. Emerging markets were up 17.1% in May and 37.9% year to date, in contrast to the 5.6% and 3% returns for the S&P 500 Index, respectively. The sharp downturn in the US dollar in May boosted returns for many emerging markets for dollar based investors; the commodity currencies, including those in Russia, South Africa and Brazil, had some of the larger gains. There has been a broad rally in most emerging markets. On average, there were 1.2 stocks with positive returns for every one stock that declined. In Turkey and Russia, 1.7 stocks rose for every stock that fell in May.

Asian markets were up 15.1%. The Chinese economy continues to reaccelerate, with the market up 17.3% in May and 32% year to date. But the more interesting recent stories in Asia have been the positive political developments in Taiwan at the end of April and the Indian election in mid-May. The previous Taiwanese government of the DPP was overtly hostile to the mainland. The election of the KMT in early 2008 promised better relations with China. Little substantive change occurred, due in large part to the global financial crisis. The markets were therefore surprised on April 29th, when China Mobile announced it would make a direct investment in a Taiwanese telecommunications company. Although the transaction itself is small, it is indicative of greater progress behind the scenes; it could not have taken place without the involvement of both governments and would have been unthinkable under the DPP. In addition, Taiwan was allowed to attend the May meeting of the World Health Organization (WHO) for the first time since 1971. Previous attendance had been effectively blocked by China. These events not only signify increased economic ties, but also should increase investor confidence in Taiwan. Fixed investment in Taiwan is meager due to its uncertain future and volatile relationship with China. More clarity on this relationship should increase investments, boosting the domestic economy. Taiwan is up 46.6% year to date.

Indian elections are a long process, with different states voting at different times, and exit polling illegal during the period. As a result, there can be great uncertainty during an election cycle. The elections that ended in mid-May resulted in a strong coalition dominated by the Congress party. The victory by Congress and its allies will result in reduced participation in government by the far left and allow the implementation of much needed economic and government reforms. This unexpected news was greeted by a sharp rally in the stock market, up 36.7% in May and 61% for the year.

Latin American shares rose 20.6% in May. Brazil was up 22%, the *real* surged against the dollar. Rising oil prices and the commodity rally benefited Brazil. Commodities also helped Peru, where mining companies comprise a significant portion of the index. As of the end of May, Argentina has been removed from the emerging markets index; effectively it was demoted to frontier status. Government policies, especially related to currency and the ability to withdraw money from the country, have been deemed inconsistent with emerging market investing.

The Eastern Europe, Middle East and Africa (EMEA) region was up 18.7%. Russia makes up approximately one third of the region, and Russia's 31.7% gain drove returns. The rise in oil prices had a meaningful impact on Russian equities and the currency. Russia's 70% return year to date makes it the best performing major emerging market. In contrast, Poland continues to struggle with excess debt and little investor confidence. Although Poland rose 3.6% in May, the market is still down over 10% for the year.

The Portfolio is still substantially overweight China. We have increased allocations to Korea and are looking to broaden diversification as the Chinese market recovers and moves closer to fair value. We are maintaining a cautious approach to most markets. Valuations are generally below long term averages, but with markets rallying as sharply as they have, a pull-back is always possible. ♦

MINDING THE FUTURE TODAY™

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