



NEWGATE
CAPITAL MANAGEMENT LLC

August 2009

FLASH REPORT: EMERGING MARKETS

Portfolio Update

Emerging market equities surged 11.3% in July and have risen over 50% year to date in US dollar terms. Good economic news has been coming in fits and starts in the developed world, but has been more uniformly positive in emerging markets. It seems clear that countries in emerging markets, especially those in Asia, are the first to recover from the recession. The more difficult issue is where the best investment opportunities are after this recent run-up in equities.

China leads all economies in reacceleration; its 7.8% GDP growth announced in July was a positive surprise. Equities rose 10.8% and are now up over 52% for the year. However, over the past 12 months, Chinese stocks are still slightly lower as this year's gain just offsets the losses for the last five months of 2008. The stimulus appears to be working, though the increase in bank lending raises the risk of banking problems at some point in the future. With a PE of 18 times current earnings, valuations in China are consistent with historical averages – not excessive, but no longer cheap. China is the only country with positive expected earnings growth for 2009 and with reasonable expectations for earnings growth in 2010. Many other countries are trading at valuation premiums relative to their history. China's current near-average valuations, despite the superior economic growth, have led us to maintain our current position of an approximately 26% allocation.

We will not maintain our China overweight indefinitely. As other economies recover, we expect to increase investments in markets like Taiwan, South Korea and India. However, after rallies of 12.2%, 18.6% and 8.9% in July, respectively, only India appears near normalized valuations. Taiwan and Korea are both relatively expensive at current levels, and we are looking for more attractive entry points.

There are signs of broader economic recovery, including increased exports from India and South Korea. Korean imports picked up in July as well, signifying an increase in overall economic activity. We expect activity to increase across the region throughout the second half of the year.

Our focus in Latin America remains in Brazil, where equities were up 8.8% in July and 72.6% for the year, the highest return of the major emerging markets. Commodity exports are an important aspect of the Brazilian economy, but local consumption and bank lending have also increased recently. Even after this year's gain, Brazilian stocks are only at average valuations, and we are maintaining a slight overweight position of 15.5% in the Portfolio. Mexican equities were up 10.6% in July, but trail for the year even as they are up 29%. The Mexican market and economy have suffered due to its strong ties to the United States, and we have remained underweight that market. The Portfolio contains small positions in Peru and Chile. Historically, these countries were viewed as access to natural resources such as copper. We also have positions in the banking sector. Economically, these countries have been somewhat insulated from the global credit crunch and are attractively valued.

The Russian market generally moves with the price of oil and was up 7.9% in July. Current oil prices mean profits for energy companies and also for the Russian government seeking to replenish its coffers after last year. The ruble has strengthened with rising oil prices and an overall improvement in the domestic economy. Russian companies are very cheap relative to their history and to the rest of emerging markets, though political concerns limit our willingness to increase our investments in the country. ♦

MINDING THE FUTURE TODAY™

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Telephone 203-661-0700 • Fax 203-661-4005 • www.newgatecapital.com