



NEWGATE  
CAPITAL MANAGEMENT LLC

September 2009

FLASH REPORT: EMERGING MARKETS

*Portfolio Update*

Emerging market equities gave back a modest 0.4% in August, not at all a surprising pull-back given last month's 11% gain and the 51% return for the year. We still see conflicting signs of economic health in the developed world, with good numbers offset by bad ones. Most negatives are coming from the labor market, where unemployment keeps rising, reducing expectations for a consumer led rebound in the US and the developed world in general. In emerging markets, the economic news is clearer. The major emerging economies do seem to be reaccelerating.

China remains the lead story, even as its markets decline. The MSCI China Index, a better representation of opportunities available for non-Chinese investors, lost 7%. The A share market, closed to all but local investors, lost nearly 20%, leading to calls of a bear market. Through this, we have maintained our overweight position to larger, domestic focused Chinese stocks. China represents an unusual opportunity for investors, it has both the highest growth projections of any country in the world and also offers the safety of massive savings that could be used for additional stimulus should the global economy decline again.

Other economies and markets are once again seeing some signs of strength. The South Korean market rose 1.2%, aided in part by its currency, which has appreciated on speculation that the central bank will have to raise interest rates by year end. We are slightly overweight there. India fell 1.1%. Even though it is one of the best performing markets this year (up 69.6%), most of the outperformance came immediately after May's surprisingly positive election. We are underweight India. While we agree that the new Indian government should have more pro-growth policies, valuations in

India are expensive by historical standards; less than 4% of the Portfolio is allocated there currently.

Brazilian stocks rose 1.7% in August and are up over 75% for the year. As with South Korea, there are expectations that the central bank will be required to raise interest rates to combat inflation. Also like Korea, the Brazilian currency has rallied sharply (over 25%) after a sharp decline in 2008. Brazil is almost 16% of the Portfolio, a modest overweight.

Mexican equities rose 5% for the month after a greater than 10% increase in July, though they still lag other emerging markets year to date. Political developments in the country warrant a high level of scrutiny. Mexican officials have started to reference Brazilian oil giant Petrobras as a possible model for Pemex, Mexico's state-owned oil company. While Petrobras has become a world leader in exploration, Pemex's production has declined. The government completely owns Pemex and uses its earnings to fund over one third of all spending. This has left little for new exploration or to increase production of existing fields. The Mexican government recently made a commitment to increase drilling in its offshore oil fields. The government is also considering sweeping changes to the tax code, which may both boost revenue but also remove some of the economically distorting features of the current tax code. We remain underweight Mexico, yet are mindful of these developments.

Eastern Europe and South Africa have the most attractive valuations in emerging markets, but also have the most political and economic questions. The Russian market gained 2.4% in August, though both Russian equities and the overall economy are still heavily reliant on energy prices. The ruble has fallen over the last three months,

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whereas most emerging market currencies have strengthened against the US dollar. The ruble is still up more than 10% against the dollar for the year after its devaluation in 2008. The Portfolio is slightly overweight Russia at 7%.

The surprising market is South Africa. Its equity market rose 5.7% in August but is still a laggard for the year, up only 40% in dollar terms. But its currency has rallied over 20% for the year and over 13% since President Zuma took office in April. There have been comparisons between

Zuma and Brazilian President Lula. Both took office after populist, pro-labor campaigns. But Lula surprised Brazil, and foreign investors, by adopting a more pro-market, fiscally conservative stance to limit inflation. President Zuma has taken similar actions in his brief time in office, including the replacement of two senior economic officials with men who have supported stronger currency policies in the past. We remain underweight South Africa, in part because of the political uncertainty around the Zuma government. ♦

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