NEWGATE
CAPITAL MANAGEMENT LLC

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• FLASH REPORT: EMERGING MARKETS •

Portfolio Update

Emerging markets had an unusual month in October. The MSCI Emerging Markets Index was essentially unchanged, pausing after the 61% climb in the first three quarters. Investors are still parsing economic data with unusual scrutiny; every number, every policy decision in every country is examined for global impact. The Israeli Central Bank's decision to be the first to raise interest rates in August received more investor attention than any other decision in its history. That it was noticed at all is evidence of the markets' hunger for any information about the health of the global economy.

Looking below the surface, there was considerable dispersion across the markets. Valuations have begun to normalize, but there are significant disparities as investors become more discerning and the rally progresses.

Improving currencies have boosted many markets both in October and for the year. Most of Brazil's 2.4% gain in the month and almost half of its over 100% gain for the year is due to the strength in the real. Brazil benefits twice from the weak US dollar: its currency appreciates, but so does the price of commodities, a major component of the equity market. Brazilian stocks comprise 17.6% of the Portfolio. Russian stocks were up 4.5% in October on the same cocktail of currency and commodity movements. Our confidence in Russia has increased due to its better economic position, and we have retained our 7.4% allocation.

The Chinese economic recovery continues to surprise all but the most bullish forecasts, helping to boost commodity export countries. Chinese GDP is again growing above the assumed 8% threshold required for "social harmony." The hard work for Chinese policy makers still lies ahead, reorienting the economy to increase domestic consumption. Chinese equities, which have lagged relative to other major emerging markets, were up 6.4%, the largest gain of any major market. China remains 25% of the Portfolio.

We have added Macau gaming and tourism as a theme in the Portfolio. Similar to Hong Kong (and geographically close), Macau is a Special Administrative Region of China, with limited autonomy from the mainland. The island's main industry is tourism and gaming, outlawed on the Chinese mainland. Both Chinese and American hotel companies have been expanding in the region, and we have made investments in several companies in this sector.

Despite strong currencies, both Taiwan and India lost 4.1% during the month. The exact performance is an odd coincidence, given how different the two economies are from each other. What they do have in common is that both markets are expensive relative to their own trading histories and to other emerging markets. Earning growth expectations are high for both countries, especially Taiwan. We have been adding to Taiwanese technology companies on this recent weakness, though our 9% allocation still represents an underweight. We have not added to India's 4.5% of the Portfolio, as the central bank has sent the market mixed signals on monetary policy. ◈

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