Global emerging markets update

Monthly commentary

August 2014

Economic & market overview

Emerging stockmarkets rose in July, outperforming their developed market peers. Emerging Asia and Latin America led gains, as China's recent targeted policies and upbeat economic data raised hopes that the mainland's economy may be turning a corner. However, geopolitical tensions and news of Argentina's debt default dampened sentiment. Robust second-quarter US GDP data also reinforced worries that the Federal Reserve could hike rates soon.

China and Indonesia were the best-performing markets in Asia. Better economic conditions supported Chinese equities. Reforms for state-owned enterprises to improve corporate governance and efficiency also buoyed investor sentiment. Indonesia advanced on expectations that the reform-minded candidate, Joko Widodo, would secure the presidential election; the governor of Jakarta was subsequently declared winner with 53% of the vote. Assuming the challenge from rival, Prabowo Subianto, is rejected by the constitutional court, Widodo will be the first Indonesian president to emerge from outside the military and the ruling elite.

In Latin America, Argentine stocks rallied before the month-end, as investors expected a resolution to its debt negotiations, but failed talks led to a missed payment to holders of its restructured bonds on 30 July. The market subsequently tumbled.

Elsewhere, most emerging European equities fell as the crisis in Ukraine intensified after the downing of a Malaysia Airlines jet. The EU and the US imposed harsher sanctions against Russia, targeting the finance, energy and defence industries. With Russian growth already stagnating over the past year, the latest round of punitive measures threatens to accelerate the economy's decline. Turkey bucked the regional trend, supported by better economic data and loose monetary policy. GDP growth gathered pace in the first quarter and the current account deficit shrunk by more than expected in May, while the recent improvement in global liquidity conditions prompted the central bank to cut interest rates for the third time in as many months.

Prospects for emerging markets appear brighter in the second half. The recent improvement in global business activity has sparked hopes that the world economy's recovery may be accelerating as monetary stimulus feeds through and fiscal headwinds subside. Liquidity is likely to remain supportive of equities, with major central banks generally keeping monetary policy loose. There will be challenges, however, when the Fed increases interest rates emboldened by the economic rebound and a tighter jobs market. Likewise, geopolitical concerns will keep investors on edge. What is key for emerging markets is the extent to which they will benefit from the recovery in the developed world. Encouragingly there are tentative signs of improving export growth, led by major developing Asian exporting nations such as Korea, Taiwan and China. In addition, recent forward-looking indicators suggest that China's targeted stimulus measures could be starting to lift economic activity, which bodes well for the rest of the developing world.

Aberdeen

Model portfolio news

In portfolio activity, we topped up Jeronimo Martins on weakness. The Portugal-listed retailer derives the majority of its revenues and earnings from Poland.

For the small-cap portfolio, we initiated a position in Grana Y Montero, a quality infrastructure operator in Peru, on the back of good prospects and attractive valuations, while selling out of Vale Indonesia after its strong rally and Regional Container Lines because of better opportunities elsewhere. We also topped up BEC World and EPAM Systems on relative price weakness, and top-sliced Valid after a period of outperformance.

Note:
Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

Corporate news

Argentina: Global steel pipe maker **Tenaris**'s management were upbeat about 2015, citing better pricing environment in the US and a clearer outlook for energy reform in Mexico. Although the company has operations in Argentina, it is unaffected by news of the country's debt default. It generates less than 10% of its sales there and the devaluation of the peso has so far reduced manufacturing costs. Separately, the US Commerce Department's decision to impose anti-dumping duties on steel pipe imports from nine countries should ease pricing pressures and nurture a recovery in margins, given that Tenaris has manufacturing operations in the US.

Brazil: Second-quarter results were generally healthy, in particular among our consumer-related holdings. Fashion retailer **Lojas Renner** benefited from robust sales and mall operator **Multiplan** reported good sales figures and occupancy rate, showing the resilience and high quality of its assets, which continue to perform well despite the challenging consumer environment. **Banco Bradesco** gained from wider net interest margins. Robust passenger traffic supported both airport operators **Asur** and **OMA**; Asur also succeeded in curbing costs incurred from re-opening one of its terminals in Cancun. Meanwhile, OMA is investing 350 million pesos to build a new terminal at Acapulco as part of its master plan.

Parque Arauco launched a new US$14 million project in Peru called Megaplaza Pisco, which is scheduled to open in the fourth quarter. Despite its small size, the development is part of the attractive pipeline of projects highlighted by the company during its capital increase earlier this year.

China/Hong Kong: **Yum! Brands** terminated its relationship with OSI Group, which is in the middle of a scandal involving the supply of poor quality meat to the mainland operations of several multinational fast food companies. Same-store sales weakened as a result, a situation we are monitoring. On a positive note, the company's Pizza Hut business is well positioned to take advantage of long-term growth in both developed and developing markets, despite weaker second-quarter sales.

China was the bright spark in **AIA**'s solid half-year results, whereas Korea was weak following the temporary suspension of telemarketing sales. The results were reassuring nonetheless and support our view that the group is poised to capture long-term regional growth. **Hang Lung** was boosted by positive rental reversion, although retail sales at its Shanghai malls were sluggish because of Beijing's anti-corruption campaign. Nevertheless, we like that these malls are in prime locations and the company is financially well positioned to open a new mall in China annually.

India: Our financial holdings **Housing Development Finance Corporation** and **ICICI Bank** posted good quarterly results and stable asset quality, despite ongoing stress in the credit system. **Infosys**'s quarterly net profits rose from the previous year and margins recovered, notwithstanding an unparalleled period of leadership changes. Among our consumer holdings, **Hindustan Unilever** and **Godrej Consumer Services** delivered volume and pricing growth.

Jordan: Drugmaker **Hikma** bought Bedford Laboratories' generic injectables manufacturing plant in the US. This is in addition to the other assets (including an injectable product portfolio and R&D pipeline) it acquired recently from Bedford, part of German drug major Boehringer Ingelheim. The plant is currently closed, pending some regulatory issues, but it should provide Hikma with much-needed spare capacity if the drugs slated for production there gained US regulatory approval.

Korea: The government is considering taxing companies' excessive cash holdings, which could improve dividend payouts to shareholders.

Samsung Electronics reported weak second-quarter results, led by declining profitability in handsets due to lower smartphone shipments and rising expenses. This was partially mitigated by good performance in the DRAM business and higher sales of its premium products in display and consumer electronics. **E-Mart** entered the convenience store arena, taking advantage of the WithMe brand it acquired two years ago. The company plans to expand its footprint to 1,000 stores by the year's end and is offering attractive franchisee terms to win market share in a sector that is growing faster than traditional supermarkets.

Mexico: Supermarket chain **Soriana**'s profits were better than expected, despite slower same-store sales. Good cost controls helped Mexican Coke bottler and convenience store operator **FEMSA** weather the new tax on soft drinks and weak demand, even though lower income from its stake in brewer Heineken hurt the bottom line.

Russia: None of our holdings in the small and large-cap portfolios have been placed on the EU and US sanctions list so far. But in retaliation to those broader sanctions, Moscow has suspended food imports from the US and EU, among others. Although food retailers including **Magnit**, **O'Key**, **X5** and Lenta will be affected, the impact on their businesses should be minor as these goods only account for a small percentage of sales.

A couple of retailers had earlier reported steady earnings despite the lacklustre economic backdrop. Magnit upgraded its full-year sales and earnings forecast after results surpassed expectations, underpinned by robust gross margins and lower operating expenses. O'Key posted revenue growth, which lifted its share price. Although its growth rates remain under pressure from competition, increased promotion and advertising activities are expected to boost results in the near future.

South Africa: **Truworths**'s annual sales growth slowed to about 7% from 11%, reflecting the impact of rising inflation and unemployment on consumer spending. Despite the disappointing update, we believe that a bottom may have been reached and that the group's earnings appear set to recover from here. Brewer **SABMiller** sold its non-core stake in Tsogo Sun, South Africa's top gaming and hotel group, for about US$1 billion. It plans to invest the proceeds in its core beverage businesses, particularly in Africa. We view the divestment as positive, even though it represents only about 1% of SABMiller's market capitalisation.

Taiwan: **Taiwan Semiconductor Manufacturing** chairman Morris Chang said the company may lose some market share in the 16-nanometre segment next year before recovering in 2016. This drew attention away from its second-quarter results, which remained solid on robust wafer demand across all segments. Profitability rose to a new high following better capacity utilisation. Costs and capital expenditure may increase for **Taiwan Mobile** in the short term as it speeds up its 4G rollout and expansion of its Momo TV shopping unit. However, we view this as a necessary step towards enhancing its core business and facilitating growth in its e-commerce unit. Meanwhile, results met forecasts amid stable contributions from its mobile service division.

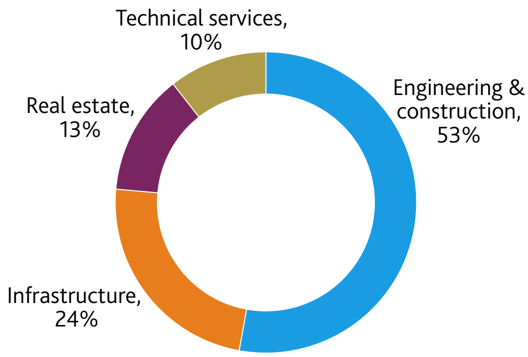
Thailand: **PTT Exploration and Production**'s chairman Suthep Liumsirijarern resigned, although he will stay on as director. The news did not surprise us, given the recent board changes at other state-owned companies as the junta consolidated control over key enterprises. The company's results were better than expected, owing to higher sales and product prices, as well as a one-off gain from an asset swap. **Siam Cement** increased its dividend payout ratio, despite lower interim profits.

Turkey: Local lenders, **Akbank** and **Garanti**, both delivered improved quarter-on-quarter results on steady margins and trading gains. **Cimsa** acquired domestic cement rival Sancim Bilecik Ciment for US$221 million. The deal will boost its capacity by 20% and is in line with its goal of expanding via acquisitions.

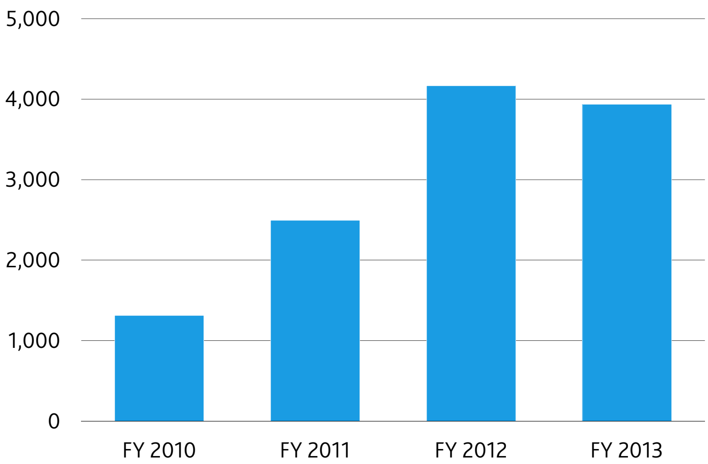
We hold the companies highlighted above.

Focus: On solid ground

EBITDA by segment



Backlog (US$ in millions)



Source: Company's 2013 annual report

Grana Y Montero (GRAM), the new addition to the GEM small-cap portfolio, is Peru's largest engineering and construction firm with a sizable presence in other parts of Latin America, namely Chile and Colombia. The company, which is already listed on the local stockmarket's good corporate governance index (the equivalent of Brazil's Novo Mercado), debuted on the New York Stock Exchange last year. Apart from its main engineering and construction arm, GRAM has other businesses spanning infrastructure, property development and the provision of technical services. Its vast business interests generate a steady stream of cash flow, which helps buffer against the cyclicality of the engineering and construction business. With a diverse backlog worth about US$4 billion, the pipeline remains robust and growth opportunities appear attractive, supported by its solid balance sheet and low leverage. After a slowdown at the start of the year, Peru's economy is expected to regain momentum in the latter half buoyed by an increase in mining and infrastructure investments. Regional spending on the sector is also expected to rise amid government efforts to bridge the infrastructure gap with other emerging regions.

Performance of Global Emerging Markets

Region/country	Index/fund	USD dollars			Local currency		
		MOM	3M	YTD	MOM	3M	YTD
Developed markets							
US	Dow Jones	-1.44%	0.48%	1.20%	-1.44%	0.48%	1.20%
US	NASDAQ Composite	-0.82%	6.55%	5.33%	-0.82%	6.55%	5.33%
US	Russell 2000	-6.05%	-0.26%	-3.06%	-6.05%	-0.26%	-3.06%
US	S&P 500	-1.38%	3.02%	5.66%	-1.38%	3.02%	5.66%
World	MSCI AC World	-1.18%	2.95%	5.24%	-0.34%	3.61%	5.35%
World	Citigroup World Government Bond	-0.94%	0.21%	4.01%	-0.94%	0.21%	4.01%
Asia Pacific							
China	MSCI China	8.16%	16.99%	7.62%	8.16%	16.95%	7.57%
Hong Kong	MSCI Hong Kong	6.01%	11.84%	10.90%	6.00%	11.80%	10.85%
India	MSCI India	1.21%	15.31%	23.34%	1.85%	15.70%	20.68%
Indonesia	MSCI Indonesia	8.18%	7.53%	32.15%	5.65%	7.68%	25.71%
Korea	MSCI Korea	1.81%	6.53%	6.19%	3.43%	5.97%	3.42%
Malaysia	MSCI Malaysia	0.09%	2.36%	3.17%	-0.38%	0.18%	0.66%
Philippines	MSCI Philippines	0.81%	5.72%	21.46%	0.42%	3.11%	18.99%
Sri Lanka	MSCI Sri Lanka	6.44%	4.20%	10.10%	6.36%	3.87%	9.61%
Taiwan	MSCI Taiwan	0.38%	9.48%	12.01%	0.82%	8.73%	12.70%
Thailand	MSCI Thailand	1.69%	5.14%	17.79%	0.61%	4.33%	15.11%
Global Emerging Markets							
Global Emerging Markets	MSCI Emerging Markets	2.02%	8.45%	8.46%	3.06%	8.61%	7.96%
	MSCI Emerging Markets Small Cap	0.80%	5.73%	9.97%	1.45%	5.73%	9.32%
Emerging Markets Europe Middle East Africa							
EMEA	MSCI EMEA	-1.88%	4.19%	0.91%	-0.04%	5.62%	4.63%
	MSCI EMEA Small Cap	0.69%	1.35%	6.28%	1.82%	3.09%	8.77%
	MSCI EM Europe 10/40	-5.59%	4.10%	-5.07%	-2.79%	5.46%	-0.57%
Czech Republic	MSCI Czech Republic	-2.74%	-3.53%	6.59%	0.30%	0.69%	10.94%
Egypt	MSCI Egypt	11.52%	4.42%	23.10%	11.52%	6.54%	26.67%
Greece	MSCI Greece	-8.33%	-9.78%	-3.35%	-6.20%	-6.51%	-0.46%
Hungary	MSCI Hungary	-11.20%	-6.72%	-15.23%	-7.73%	-1.14%	-7.63%
Poland	MSCI Poland	-5.79%	-6.19%	-3.35%	-3.12%	-3.24%	0.02%
Russia	MSCI Russia	-8.44%	8.44%	-13.18%	-4.97%	8.50%	-7.23%
South Africa	MSCI South Africa	0.90%	5.82%	10.71%	1.64%	7.69%	13.28%
Turkey	MSCI Turkey	3.94%	11.52%	25.68%	5.15%	12.99%	25.49%
Middle East							
Bahrain	Bahrain All Share Index #	3.10%	3.11%	17.84%	3.09%	3.11%	17.84%
Kuwait	Kuwait Stock Exchange Index #	1.93%	-4.29%	-5.73%	2.29%	-3.74%	-5.55%
	MSCI Kuwait	2.38%	-2.64%	10.90%	2.98%	-1.84%	11.24%
Oman	Muscat Securities Market Index #	2.77%	7.04%	5.36%	2.75%	7.04%	5.36%
Qatar	QE Index #	12.09%	1.58%	24.09%	12.09%	1.58%	24.06%
	MSCI Qatar	12.39%	-2.25%	22.25%	12.41%	-2.24%	22.24%
Saudi	Tadawul All Share Index #	7.38%	6.57%	19.67%	7.38%	6.57%	19.67%
UAE - Abu Dhabi	ADX General Index #	11.06%	0.20%	17.82%	11.07%	0.20%	17.82%
UAE - Dubai	Dubai Financial Market General Index #	22.57%	-4.46%	43.42%	22.58%	-4.46%	43.43%
	MSCI UAE	13.70%	-4.42%	34.23%	16.89%	-1.74%	37.99%
Israel	MSCI Israel	0.95%	5.38%	22.72%	0.90%	4.33%	21.17%
Jordan	MSCI Jordan	-0.98%	-3.48%	9.50%	-1.18%	-3.52%	9.50%

Region/country	Index/fund	USD dollars			Local currency		
		MOM	3M	YTD	MOM	3M	YTD
Latin America							
Latin America	MSCI Latin America	1.06%	5.21%	8.54%	3.50%	6.32%	6.99%
	MSCI Latin America Small Cap	-3.99%	1.82%	-0.31%	-1.49%	3.12%	-1.23%
Argentina	MSCI Argentina	6.31%	23.52%	33.57%	6.31%	23.52%	33.57%
Brazil	MSCI Brazil	1.88%	5.56%	12.82%	4.74%	7.02%	8.36%
Chile	MSCI Chile	-4.85%	-3.80%	-4.44%	-1.38%	-2.18%	4.36%
Colombia	MSCI Colombia	0.11%	4.96%	13.53%	-0.03%	1.96%	10.30%
Mexico	MSCI Mexico	1.39%	7.75%	2.71%	3.43%	8.93%	3.78%
Peru	MSCI Peru	-0.65%	0.76%	12.49%	-0.65%	0.76%	12.49%
Frontier Markets							
FM (FRONTIER MARKETS)	MSCI Frontier Markets	1.75%	7.87%	22.65%	2.16%	8.69%	23.25%
Botswana	MSCI Botswana	4.94%	7.38%	-2.11%	6.01%	9.05%	-0.85%
Bulgaria	MSCI Bulgaria	-5.13%	-9.71%	8.65%	-2.95%	-6.46%	11.90%
Croatia	MSCI Croatia	-2.83%	2.32%	-5.95%	0.19%	6.43%	-2.90%
Estonia	MSCI Estonia	-6.07%	-7.20%	-15.69%	-3.88%	-3.83%	-13.17%
Ghana	MSCI Ghana	-8.62%	-19.18%	-23.02%	-4.77%	-1.05%	12.79%
Jamaica	MSCI Jamaica	1.56%	-1.69%	0.90%	2.14%	0.72%	7.07%
Kazakhstan	MSCI Kazakhstan	6.96%	28.79%	19.68%	6.96%	28.79%	19.68%
Kenya	MSCI Kenya	1.26%	3.71%	16.08%	1.45%	4.65%	18.10%
Lebanon	MSCI Lebanon	-5.60%	-2.52%	10.58%	-5.60%	-2.52%	10.58%
Lithuania	MSCI Lithuania	-1.38%	-1.92%	6.02%	0.91%	1.64%	9.19%
Mauritius	MSCI Mauritius	0.54%	-0.17%	3.06%	1.71%	1.83%	4.77%
Morocco	MSCI Morocco	1.15%	-0.55%	5.36%	3.29%	2.54%	7.96%
Nigeria	MSCI Nigeria	1.29%	11.68%	2.18%	0.70%	12.58%	3.42%
Romania	MSCI Romania	-4.38%	8.82%	12.63%	-1.17%	12.46%	15.04%
Serbia	MSCI Serbia	-1.41%	-0.47%	1.43%	1.68%	4.12%	6.38%
Slovenia	MSCI Slovenia	-4.83%	3.17%	9.08%	-2.61%	6.91%	12.34%
Tunisia	MSCI Tunisia	0.60%	-0.89%	4.25%	3.16%	6.92%	9.43%
Ukraine	MSCI Ukraine	17.33%	34.66%	40.78%	22.57%	42.49%	109.72%

All performance are measured using total return except for those marked #
Performance are measured based on price performance
Source: Bloomberg, 31 July 2014

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