Schroder ISF* Global Emerging Market Opportunities
Monthly Fund Update

Market Review

The MSCI World index delivered negative returns in June as investors reduced risk amid fears that the global recovery was losing momentum. Headwinds from weaker-than-expected US data towards the end of the month, the Euro-zone debt crisis and China's continued efforts to prevent its own economy from overheating negatively impacted investor confidence. Although the MSCI Emerging Markets index outperformed developed markets it still ended slightly down over the month.

Our core markets in June were Korea, Russia, Turkey, Thailand, Indonesia and Egypt. Indonesia was the strongest performing country in the index after markets responded positively to the appointment of a new finance minister. Although inflation has remained under control – helped by the rupiah's strength – consumer price inflation for June was significantly above expectations, heightening the risk of interest rate hikes. Across the country investment is rebounding, along with consumer confidence and the World Bank raised its 2010 GDP forecast from 5.6% to 5.9%. Ratings agency Moody's upgraded the country's sovereign debt. Korea, Thailand and Turkey also delivered positive returns. In Thailand, economic data continued to surprise on the upside with 1Q GDP up 12% year-on-year. The rebound has been led by private and government consumption as well as inventory growth rather than investment and exports. By contrast, Egypt fell during June on signs that private investment remains sluggish and is falling short of the level needed to cut the country's 9% unemployment rate. Russia also delivered a negative return. The country's energy-dominated economy remains highly sensitive to fluctuations in risk appetite which declined over the month as the outlook for global growth deteriorated. Inflation – while showing signs of easing – also remained high. However, the latest data suggests that economic fundamentals in the country are improving with 2010 is seeing a strong recovery from very depressed levels of activity in 2009.

Performance comment

The fund delivered a positive absolute return in June. Among our core markets, our exposure to Thailand (improved outlook for growth, attractive valuations), Turkey (among our core markets due to attractive valuations and an improving growth outlook) and Indonesia (which remains among our core markets as, despite high valuations the growth outlook looks strong and sustainable) had a positive impact. Our exposure to Russia (where we believe valuations are attractive) and Egypt detracted over the month. In the non-core segment of the portfolio, the fund's exposure to China, India and Brazil was positive whereas our exposure to South Africa and Poland was negative.

The market outlook and portfolio strategy

We have been somewhat cautious on the short-term outlook for emerging markets since January, and we continue to hold this view. Chinese policy tightening and fiscal problems in the developed world remain headwinds for emerging markets. However, prices have come down and we are now running cash at 5% only. Global liquidity is likely to remain abundant for most of this year, valuations are reasonable, and corporate earnings in the GEM region are expected to grow by 30% this year.

If, as expected, US growth continues to fade in H2 and concerns over sovereign contagion continue, investors are likely to focus on the stronger fundamentals and growth potential of the emerging world.

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Currently our core markets are Indonesia (strong roe, but fully valued, poor relative earnings outlook, structural improvements), Korea (attractive valuations, strong earnings), Thailand (improved growth outlook, attractive valuations, ongoing political concerns), Hungary (attractively valued, near term economic concerns, discounted in price), Russia (improving economic fundamentals, attractive valuations, liquidity supportive) and Turkey (attractive valuations, improving growth outlook, inflation and interest rate concerns diminishing).

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