

Global Emerging Markets Update



Economic and market overview

Emerging markets fell in May, touching their lowest level in nine months at one point, amid long-running concerns over debt contagion in Europe's fiscally troubled periphery and policy tightening in China, which drove up volatility and risk aversion. China's rebuttal to claims it was reviewing its Eurozone debt holdings and positive US sales numbers that boosted prospects for exports reassured markets towards the month-end, helping to curtail the losses.

Economic news was largely positive. In Asia, first-quarter GDP data was generally upbeat, aided by healthy domestic consumption and improving exports. Mexico and South Africa's economies also continued to expand, while elsewhere manufacturing activity gathered pace. Still, the picture was not all rosy as unemployment worsened in some countries.

Inflation remained tame in Mexico and the Czech Republic, allowing the latter to cut interest rates. But rising prices and the fastest quarterly economic expansion in a decade prompted Malaysia to raise its overnight policy rate in May. In China, overheating fears persisted as bank lending, property values and consumer prices accelerated. Over in Hong Kong, the government will continue to boost land supply to cool the property sector. Meanwhile, India proposed a US\$11 billion fund for infrastructure needs, even as inflation quickened.

In politics, Agus Martowardojo became Indonesia's new finance minister after Sri Mulyani Indrawati quit to join the World Bank. In Thailand, weeks of anti-government protests were finally quelled after a bloody showdown between the army and the red shirts. Elsewhere, a three-week transport strike in South Africa, which crippled exports, ended. In Eastern Europe, Viktor Orban was sworn in as Hungary's new prime minister; his government will focus on growth rather than cutting the budget and called for lower interest rates. On the other hand, parties that pledged to reduce spending won the most votes in parliamentary elections in the Czech Republic.

Investors remain nervous as Europe's debt problems have generated concerns about the safety of sovereign debt and depressed global markets. While the Eurozone's massive rescue package may have staved off an immediate liquidity and default crisis, the stark austerity measures needed to support the more fiscally challenged EU countries may dampen economic growth. This, combined with China's moves to cool its runaway property sector, is compounding fears that the global economy may suffer a double-dip.

For emerging markets, the problems in Europe may lessen the case for the further normalisation of monetary conditions, at least in the near term. Still, policymakers are likely to continue to target specific market segments that are overheating, such as China's property sector.

Despite these headwinds, emerging markets remain fundamentally sound, with low debt levels, a growing middle class and deepening intra-regional trade. A further correction in markets resulting from continued risk aversion would represent a buying opportunity into the long-term attractiveness of the asset class.

Portfolio activity

During the month, we increased our exposure to Poland's Bank Pekao, while paring Israeli holdings Teva Pharmaceutical and Check Point Software following their good relative performance.

Note: The changes mentioned in this part refer to our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations among these, so the above descriptions might not apply to the actual portfolios.

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Corporate news

Argentina: Tenaris' first-quarter profits were hurt by weaker contributions from its projects division.

Brazil: Quarterly earnings news was encouraging: higher prices boosted the performance of **Vale** and **Petrobras**; **Multiplan** was supported by rising rents; while **Ultrapar** reported good operating results. Petrobras and Vale continued to forge strategic partnerships separately. The former announced an ethanol tie-up with France's Tereos and a bio-diesel project with Portugal's Galp Energia, as well as purchased Gas Brasileiro Distribuidora from Italy's Eni for US\$250 million. Vale is buying a stake in Brazilian fertilizer producer Fosfertil and the local fertilizer assets of Bunge. Meanwhile, Multiplan will invest one billion reais in mixed property developments in the next two years. **Bradesco** proposed increasing its capital stock by 2 billion reais, resulting in a 10% share bonus; separately, it decided to let shareholders redeem US\$300 million-worth of bonds early.

China/Hong Kong: Swire Pacific shelved the initial public offering of its property division owing to weak demand. A recovery in crude oil prices boosted **PetroChina's** profits in the first quarter. Its parent, CNPC, will acquire a 35% stake in Shell's Syrian oil and gas unit.

Hungary: Despite its resilient operational performance, **Gedeon Richter** posted weaker first-quarter results owing to lower foreign exchange gains.

India: Our holdings posted positive results: **HDFC** benefited from solid loan growth for the full year and **Grasim Industries** gained from healthy cement demand. **ICICI Bank** will buy Bank of Rajasthan in a move that will add over 460 branches to its network.

Israel: Teva Pharmaceutical's first-quarter profits were lifted by robust US sales.

Korea: Samsung Electronics' first-quarter results impressed as supply constraints and better-than-expected sales drove memory prices; it is investing more to address the supply shortage and widen the technology gap with its rivals by increasing capital expenditure to 18 trillion won this year.

Daegu Bank's net interest income grew but its asset quality deteriorated.

Malaysia: CIMB Group is boosting its presence in Asia: it is seeking a secondary listing in Indonesia to enhance its brand and expand its operations. The lender is also increasing its stake in Indonesian subsidiary CIMB-Niaga by buying a 19.67% stake from state investment agency Khazanah, which it will fund via a new issue of up to 134 million shares at M\$14.50 each. In Cambodia, it obtained a banking licence to set up a wholly owned subsidiary. On the earnings front, the group's first-quarter net profits rose on lower provisions and higher non-interest income.

Mexico: Asur reported a year-on-year decline in April passenger numbers, whereas **Soriana** is likely to double the number of stores it opens annually after it repays debt related to a recent acquisition.

Philippines: In first-quarter results, **Ayala Land's** increase in net income was driven by stronger home sales but the **Bank of the Philippine Island's** net profits fell because of higher expenses and provisions for income tax.

Poland: Bank Pekao posted decent first-quarter results, aided by improved net interest margins; it further strengthened its capital adequacy base.

Taiwan: Taiwan Mobile posted resilient first-quarter earnings though management warned that price cuts and elevated costs could hurt second-quarter performance. Nevertheless, it proposed a dividend payout of NT\$5.03 per share. **TSMC's** results were boosted by strong demand and margin improvement.

Thailand: Siam Cement's results were underpinned by its chemicals and paper divisions. **PTT Exploration and Production's** earnings rose on higher selling prices, lower costs and a one-off tax gain.

Turkey: Discount retailer **BIM's** first-quarter gains were underpinned by solid sales. In contrast, **Akbank** might see its margins come under pressure on the back of higher domestic deposit costs.

We hold the companies highlighted above.

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Performance of Global Emerging Stock Markets (%)

REGION/COUNTRY	INDEX/FUND	MOM	USD DOLLARS		LOCAL CURRENCY		
			3M	YTD	MOM	3M	YTD
DEVELOPED MARKETS							
US	Dow Jones	-7.56	-1.16	-1.63	-7.56	-1.16	-1.63
UK	FTSE Allshare	-11.03	-5.99	-11.54	-6.18	-1.16	-1.42
Europe	FT Europe ex UK	-12.74	-9.56	-17.43	-5.57	0.00	-4.59
World	MSCI AC World Free	-9.39	-3.31	-6.25	-7.18	-0.84	-2.87
World	Citigroup World Government Bond	-1.05	-3.08	-2.71	-1.05	-3.08	-2.71
ASIA PACIFIC							
EM Asia	MSCI Emerging Markets Asia	-8.57	0.83	-5.10	-5.57	1.49	-4.65
	MSCI Emerging Markets Asia Small Cap	-10.49	0.24	-4.68	-7.52	0.78	-4.37
China	MSCI China	-5.36	-0.57	-7.16	-5.08	-0.26	-6.77
Hong Kong	MSCI Hong Kong	-6.36	-3.58	-6.41	-6.08	-3.28	-6.01
	MSCI Zhong Hua	-5.64	-1.44	-6.92	-5.36	-1.14	-6.53
India	MSCI India	-7.99	2.40%	-1.71	-3.83	2.98	-2.07
Indonesia	MSCI Indonesia	-7.56	9.78	7.91	-5.91	7.90	5.38
Korea	MSCI Korea	-13.31	0.14	-4.72	-5.99	3.78	-1.65
Malaysia	MSCI Malaysia	-6.93	5.90	5.89	-4.68	1.42	0.86
Pakistan	MSCI Pakistan	-12.56	-4.40	-2.34	-11.25	-4.11	-1.25
Philippines	MSCI Philippines	-4.43	6.10	5.69	-0.54	6.44	5.78
Singapore	MSCI Singapore	-8.87	0.45	-4.82	-6.92	0.04	-5.09
Sri Lanka	MSCI Sri Lanka	-0.01	10.12	6.00	-0.14	9.33	5.44
Taiwan	MSCI Taiwan	-9.82	-1.28	-11.06	-8.00	-1.59	-11.10
Thailand	MSCI Thailand	-2.70	8.72	7.43	-2.23	6.90	4.75
GLOBAL EMERGING MARKETS							
Global Emerging Markets	MSCI Emerging Markets	-8.75	-0.16	-5.36	-5.17	0.87	-3.69
	MSCI Emerging Markets Small Cap	-10.43	-0.06	-3.50	-7.07	0.83	-2.13
EMERGING MARKETS EUROPE MIDDLE EAST AFRICA							
EMEA	MSCI EMEA	-9.66	-0.50	-4.03	-4.97	2.40	0.18
	MSCI EMEA Small Cap	-11.91	0.38	0.59	-7.25	3.16	5.81
Czech Republic	MSCI Czech Republic	-12.12	-8.89	-11.17	-5.06	-0.34	0.38
Egypt	MSCI Egypt	-12.99	-2.56	6.09	-11.53	0.23	9.23
Hungary	MSCI Hungary	-22.51	-8.41	-12.43	-13.67	4.03	4.30
Morocco	MSCI Morocco	-6.91	0.45	4.04	-0.51	9.56	18.20
Poland	MSCI Poland	-14.65	-5.84	-11.59	-3.81	8.29	2.59
Russia	MSCI Russia	-11.04	-2.78	-5.68	-6.68	0.09	-3.96
South Africa	MSCI South Africa	-7.33	3.90	-1.93	-3.15	4.24	2.41
Turkey	MSCI Turkey	-11.36	10.62	-0.90	-6.11	12.88	3.99
MIDDLE EAST							
Bahrain	Bahrain All Share Index ^A	-8.90	-4.47	-0.55	-8.90	-4.46	-0.55
Kuwait	Kuwait Stock Exchange Index ^A	-8.23	-8.97	-4.97	-8.22	-9.20	-4.36
	MSCI Kuwait	-9.15	-6.87	6.38	-5.04	-2.49	11.83
Oman	Muscat Securities Market Index ^A	-7.85	-5.90	-1.18	-7.85	-5.90	-1.17
Qatar	Doha Securities Market Index ^A	-10.08	-1.40	-2.46	-10.09	-1.26	-2.49
	MSCI Qatar	-10.00	1.66	3.49	-10.05	1.78	3.44
Saudi	Tadawul All Share Index ^A	-10.88	-4.93	0.00	-10.88	-4.92	-0.02
UAE - Abu Dhabi	Abu Dhabi Securities Market ^A	-6.23	-3.67	-5.08	-6.23	-3.68	-5.08
UAE - Dubai	Dubai Financial Market General Index ^A	-9.22	-0.84	-12.42	-9.22	-0.84	-12.42
	MSCI UAE	-12.43	6.56	-8.86	-12.43	6.57	-8.87
Israel	MSCI Israel	-10.99	-11.28	-9.06	-7.31	-9.04	-6.99
Jordan	MSCI Jordan	-6.70	-1.50	-8.73	-6.80	-1.57	-8.73
LATIN AMERICA							
Latin America	MSCI Latin America	-8.59	-2.46	-7.38	-4.40	-1.95	-4.70

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REGION/COUNTRY	INDEX/FUND	MOM	USD DOLLARS		LOCAL CURRENCY		
			3M	YTD	MOM	3M	YTD
	MSCI Latin America Small Cap	-8.33	-3.83	-3.76	-4.16	-3.32	-1.04
Argentina	MSCI Argentina	-10.95	2.22	-5.71	-10.95	2.22	-5.71
Brazil	MSCI Brazil	-10.48	-4.81	-11.36	-6.16	-4.53	-7.75
Chile	MSCI Chile	-1.76	-0.05	2.15	1.01	0.63	6.94
Colombia	MSCI Colombia	-1.72	2.09	9.11	-0.65	4.25	5.35
Mexico	MSCI Mexico	-6.48	3.32	1.00	-1.31	4.55	-0.01
Peru	MSCI Peru	2.97	8.02	4.74	2.97	8.02	4.74
FRONTIER MARKETS							
Frontier Markets	MSCI Frontier Markets	-9.15	-1.95	1.31	-7.11	0.51	4.62
Botswana	MSCI Botswana	-6.71	-8.47	-2.55	-2.68	-6.56	3.74
Bulgaria	MSCI Bulgaria	-17.23	-19.24	-23.09	-10.32	-10.20	-10.07
Croatia	MSCI Croatia	-11.67	-11.77	-7.76	-4.22	-2.31	7.35
Estonia	MSCI Estonia	-20.00	-6.57	19.38	-13.31	3.91	39.59
Ghana	MSCI Ghana	-0.74	26.62	36.25	0.23	26.88	36.09
Jamaica	MSCI Jamaica	-7.14	14.35	13.10	-7.66	12.69	11.89
Kazakhstan	MSCI Kazakhstan	-13.14	-12.64	-15.13	-13.14	-12.64	-15.13
Kenya	MSCI Kenya	-1.60	10.96	18.90	1.91	15.37	25.25
Lebanon	MSCI Lebanon	-0.72	3.41%	0.67	-0.72	3.40	0.67
Lithuania	MSCI Lithuania	-9.92	-11.45	-0.16	-2.39	-1.52	16.74
Mauritius	MSCI Mauritius	-13.15	-11.64	-17.08	-6.17	-4.30	-9.15
Nigeria	MSCI Nigeria	-5.15	9.12	22.28	-4.90	9.84	23.79
Romania	MSCI Romania	-19.49	-15.41	-9.27	-11.38	-3.97	5.12
Serbia	MSCI Serbia	-21.94	-12.39	-8.15	-12.57	0.23	14.83
Slovenia	MSCI Slovenia	-13.47	-13.11	-18.00	-6.24	-3.36	-4.12
Tunisia	MSCI Tunisia	-0.88%	-0.76	0.87	4.76	7.97	15.18
Ukraine	MSCI Ukraine	-27.26	-1.18	18.14	-27.24	-1.81	16.89

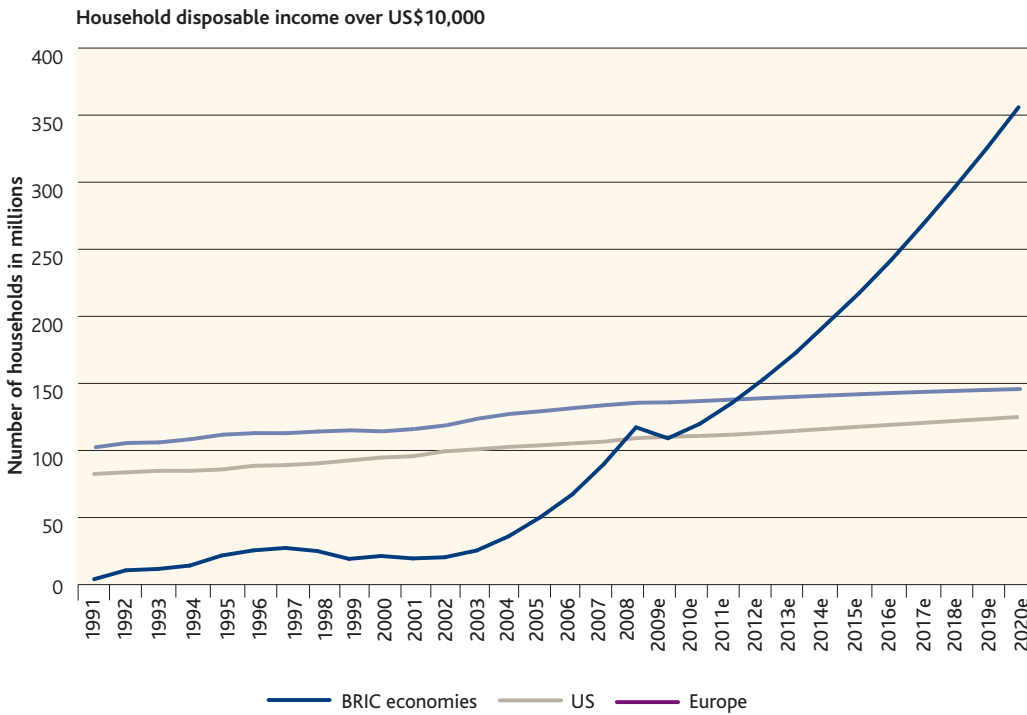
As at 31 May 2010.

All performance are measured using total return except for those marked ^.

Source: Bloomberg

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Focus – In the overtaking lane



Source: Morgan Stanley Research, 4 June 2010

In the BRIC economies, the number of households with a disposable annual income of over US\$10,000 is likely to overtake that in the developed economies within the next few years. Greater job opportunities, low debt levels and rising wages have fomented middle class aspirations that are driving final private demand. Inadvertently, the ongoing debt problems in the Eurozone that is threatening to delay recovery in the West may also be the very catalyst needed to encourage emerging economies to become more self reliant and prompt governments to place greater importance on growing domestic consumption.

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During the month, we met with the following companies:

Brazil: BM&Fbovespa, Bradespar, Embraer, Iguatemi, Lojas Renner, Totvs, Ultrapar.

Chile: Parque Arauco.

China: Agricultural Bank of China, Baidu, China Mengnui Dairy, China Mobile, Sinopec, China South Locomotive & Rolling Stock, Dongfeng Motor, PetroChina, Towngas China, XinAo Gas.

Hong Kong: Cheung Kong (Holdings), China Life Insurance, CLP Power HK, Li & Fung (Trading), Stella International Holdings, The Wharf (Holdings).

India: ABB India, Ashok Leyland, Eicher Limited (and Eicher Motors), Gas Authority of India, Godrej Consumer Products, Grasim Industries, ING Vysya Bank, Oberoi Realty, Shopper's Shop.

Indonesia: ACE Hardware, Delta Dunia, Indika Energy, Indosat, International Nickel Indonesia, MP Evans, Petra Foods, PT Energi Mega Persada, Ramayana Lestari Sentosa, Telekomunikasi Indonesia.

Israel: Retalix, Nice Systems, Osem, Paz Oil, Gan Shmuel Group, Teva Pharmaceutical, Ituran, Frutarom, Clal Insurance, Plasson, Hadera Papers, Check Point Software, Shufersal, Dan Vehicle, Golf&Co, Azrieli Group, Harel Insurance, Bezeq, FMS.

Korea: Busan Bank, Korea Telecom, LG Electronics, Samsung Electronics.

Malaysia: Bursa Malaysia, Hong Leong Bank.

Mexico: Coke Femsa, Contal, Femsa.

Oman: Shell Oman Marketing.

Qatar: Commercial Bank of Qatar, Qatar Insurance Company.

Russia: Magnit, MMK, Baltika, Bank St. Petersburg, Gazprom, Lukoil, MTS, Novatek, Novolipetsk Steel, Novorossiysk Commercial Sea Port (NSCP), Pharmstandard, Rosneft, Sberbank, Svyazinvest, TMK, Vozrozhdeniye Bank, Wimm-Bill-Dan, X5 Retail Group.

South Africa: AngloGold Ashanti, Life Healthcare.

Sri Lanka: Central Bank of Sri Lanka, John Keells Holdings.

Taiwan: Giant Manufacturing, TSMC, Uni-President Enterprises, United Microelectronics.

Thailand: Bumrungrad Hospital, Hana Microelectronics, Minor International, PTTEP, Siam Commercial Bank, Tisco Bank, Total Access Communication.

Turkey: Turk Ekonomi Bankasi.

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