Global emerging markets update

Monthly commentary

August 2015

Economic & market overview

Emerging market equities extended their losses in July amid continued volatility in China's stockmarkets and anxiety over the fate of Greece's economy. Chinese markets had a particularly rough month. To prevent a panic Beijing barred major shareholders and executives of listed companies from selling shares, while over 1,000 companies suspended trading. Even so, markets continued to recoil from lacklustre industrial profits and manufacturing activity. In Greece, embattled prime minister Alexis Tsipras suffered a mutiny from leftists in the Syriza party unhappy with the deal he struck with creditors to keep the nation in the Eurozone.

A renewed sell-off in commodities, led by oil, did not help sentiment either. OPEC producers are pumping at record levels despite a supply glut propelled by US shale-oil production, while Iranian supply appears set to return to the market when sanctions linked to a "toned-down" nuclear programme are lifted.

The market declines were exacerbated by a rout in emerging market currencies, as investors continued to weigh the timing of a Federal Reserve rate hike. The Russian rouble was among the worst hit. It fell sharply against the US dollar after oil prices sank below US$50 per barrel; the central bank's rate cut piled further pressure on the currency. The Turkish lira and the local stockmarket were hit by escalating violence along its border with Syria. Concern that Brazil's credit rating could be downgraded to junk status weighed heavily on the real. The government had cut this year's target for a fiscal surplus (seen as a gauge of the country's ability to pay down debt), raising fears of a downgrade, which would be a setback to president Dilma Rousseff's plans to revive investment and growth. The central bank raised interest rates to a new high of 14.25% in July, but signalled that it was near the end of a tightening cycle. The Malaysian ringgit also plumbed new multi-year lows as investigations into the alleged misuse of funds related to state-owned investment company 1MDB widened. Prime minister Najib Razak, who has been drawn into the scandal following allegations that money flowed into his personal bank accounts, sacked his deputy and the attorney-general along with several others in his cabinet.

Flagging economic growth in China and weaker commodities underscore a slowing global economy. Emerging markets are vulnerable given their reliance on external trade. Capital outflows are putting further pressure on their currencies, aggravating fundamentals. In Europe, Greece appears to have avoided an imminent default after reaching a deal with its creditors on the terms of a third bailout, but concern over its ability to pay without some form of debt forgiveness remains. The long-awaited normalisation in US monetary policy could push the dollar higher although that is a concern as it emphasises the Fed's policy divergence from other central banks. We anticipate further volatility in the months ahead. Our holdings will not be immune from the market noise, but they have weathered similar challenges before. Longer term prospects remain encouraging.

Model portfolio news

No major changes were made to the large-cap portfolio in July.

For the small-cap portfolio, we initiated positions in Nigeria's Zenith Bank and Indonesian home-improvement chain Ace Hardware, and increased the weighting in Juhayna Food Industries, all on valuation grounds. Against this, we sold Hering on quality concerns and better opportunities elsewhere, and top-sliced Texwinca following its good share price performance.

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

Brazil: In quarterly earnings news, **Lojas Renner** posted impressive sales growth; the clothing retailer has been winning market share and focusing on operational improvements. Mall operator **Multiplan** benefited from steady rental revenues, although sales at its malls showed notable deceleration amid a weaker economy. **Banco Bradesco**'s results exceeded expectations, as growth in net interest and fee income outweighed higher provisions. Separately, the Brazilian lender is buying HSBC's local business for US$5.2 billion in cash. The deal will help narrow Bradesco's asset gap with other domestic rivals. HSBC Brazil's focus on high-income customers fits well into Brasdesco's plan to ramp up sales of specialised financial services for the high-end income segment. Dental health insurance provider **Odontoprev** saw better margins and cash generation despite slowing sales.

Chile: Mall operator **Parque Arauco** posted good quarterly results with solid top-line growth on the back of expansion, while sustaining high occupancy rates. IT company **Sonda**'s earnings were slightly ahead of expectations as top-line growth in Chile and Mexico compensated for weakness in Brazil.

China/Hong Kong: The UK will introduce an 8% surcharge on domestic banks from next January. In return, it will reduce the bank levy from 0.21% to 0.1% in 2021; by then, the levy will apply only to UK profits instead of global earnings, which seems like good news for **Standard Chartered**.

India: **ICICI Bank**'s relatively resilient retail business offset softer performance from its corporate divisions. Management expects non-performing loan growth to remain relatively stable year-on-year. **Housing Development Finance Corp** continued to do well, enjoying healthy loan and margin growth, while maintaining decent asset quality.

Indonesia: **Astra International** posted a weak second quarter as profits fell 20% from a year earlier, largely because of the poor performance in its auto and plantation divisions, although the mining services unit fared better.

Jordan: The wave of consolidation in the pharmaceutical industry continued apace, this time with **Hikma** buying German drugmaker Boehringer Ingelheim's generics business (Roxane) for US$2.65 billion in cash and stock to bolster its US presence. The Jordan-based drugmaker is already a market leader in generic injectables and this acquisition will beef up non-injectables. The transaction is the latest in a string of deals in the generics sector, where economies of scale are beneficial in a highly competitive environment.

Kenya: **East African Breweries** posted impressive net profits that were boosted by significant cost reductions. The beer maker said it would try to convince Tanzanian authorities not to revoke its merger with Serengeti Breweries.

Korea: Cheil Industries' proposal to buy out Samsung C&T for US$8 billion was approved by shareholders, despite the opposition of vocal minority investors (including our colleagues in passive equities) who felt the deal undervalued Samsung C&T's assets. Thanks to the various crossholdings, the buyout increases the Lee family's direct interest in Samsung Electronics, the group's crown jewel. In so far as it clarifies the succession among the family's heirs it is positive (with the patriarch now bedridden). But the manner of the acquisition leaves a lot to be desired. Separately, **Samsung Electronics**' second-quarter net profits fell amid intense competition in the mobile segment, although losses were mitigated by a solid showing in semiconductors.

Mexico: Convenience store operator and beverage company **FEMSA** also did well. Good performance from retail arm Femsa Comercio, which achieved its highest same-store sales growth since 2012, more than compensated for a weaker showing from its Coca-Cola bottling unit KOF, which suffered from ongoing challenges in Venezuela. **Banorte**'s results met expectations as improvements in efficiency offset a modest contraction in the net interest margin.

Poland: Polish-Portuguese food retailer **Jeronimo Martins** reported solid quarterly earnings and modest growth in same-store sales despite deflation, benefiting from promotions and store refurbishments.

Russia: Food retailers **Magnit** and **O'Key**'s earnings contrasted with each other. Higher margins helped Magnit post better-than-expected interim results. It is stepping up its domestic expansion plans this year to build on its low-cost appeal amid the grim economic backdrop. O'Key, on the other hand, was hampered by the economic slowdown and tougher competition – sales declined over the first half and it will likely launch its new discount-store format soon.

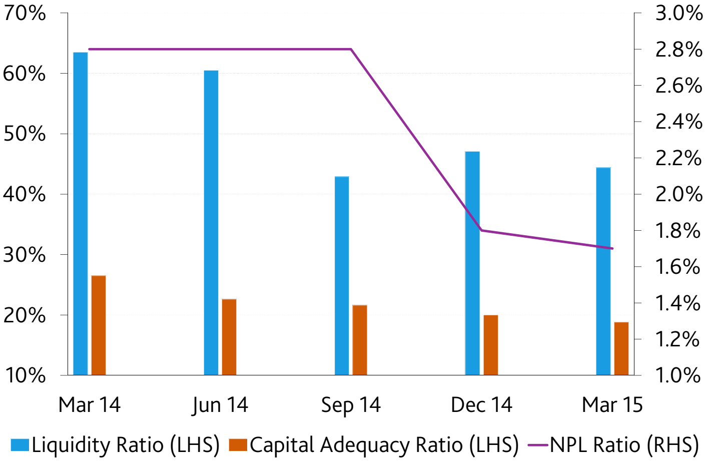
Peru: **Grana y Montero**'s earnings were lacklustre: it continued to face margin compression because of cost overruns at its engineering and construction divisions, as well as muted performance at its property arm. On a brighter note, the company has been awarded a US$68 million contract to build telecom infrastructure in Chile.

South Africa: Both **BHP Billiton** and its spinoff **South32** delivered solid production numbers. At the same time, South32 reported a net cash balance sheet of US$54 million. BHP, meanwhile, expects full-year earnings to include impairment charges on its US oil-and-gas assets.

Thailand: **Siam Cement** expects good cement demand in the second half to buttress full-year results. The company's second-quarter net profits surged 63% from a year ago, driven by healthy chemical margins and an inventory gain.

We hold the companies highlighted above.

Focus: In the top league



Source: Company data, March (Q1) 2015

Zenith Bank, one of Nigeria's largest lenders, is the latest addition to the small-cap portfolio. With over 500 locations nationwide, Zenith controls a significant share of the high-end corporate segment (mostly MNCs) in strategic sectors of the domestic economy. Operating in an unsophisticated banking sector has generated good returns. First-quarter net profits grew by 17% year-on-year to 27.6 billion naira, while its conservative lending policy has lowered non-performing loans. The bank has also made steady progress in keeping costs at a reasonable level while improving profitability. Although the slowdown in domestic growth has made for a tougher operating environment, the bank is well positioned to benefit from the country's economic recovery over the longer term. Africa's most populous nation, Nigeria has a significant retail market waiting to be tapped. Meanwhile, the bank is setting its sights on expanding modestly across the continent. Its robust liquidity and solid capital base provides support for that ambition.

Performance of Global Emerging Markets

Region/country	Index/fund	US dollars			Local currency		
		MOM	3M	YTD	MOM	3M	YTD
Developed markets							
US	Dow Jones	0.52%	-0.22%	0.55%	0.52%	-0.22%	0.55%
US	NASDAQ Composite	2.88%	4.08%	9.05%	2.88%	4.08%	9.05%
US	Russell 2000	-1.16%	1.85%	3.54%	-1.16%	1.85%	3.54%
US	S&P 500	2.10%	1.41%	3.35%	2.10%	1.41%	3.35%
World	MSCI AC World	0.90%	-1.48%	3.90%	1.81%	-0.15%	6.50%
World	Citigroup World Government Bond	0.48%	-2.15%	-3.56%	0.48%	-2.15%	-3.56%
Asia Pacific							
EM Asia	MSCI Emerging Markets Asia	-7.12%	-13.20%	-2.27%	-5.44%	-10.32%	0.18%
	MSCI Emerging Markets Asia Small Cap	-8.51%	-11.80%	3.17%	-6.58%	-8.56%	5.98%
China	MSCI China	-10.75%	-18.75%	2.49%	-10.75%	-18.74%	2.46%
China	MSCI China A	-14.41%	-17.51%	14.63%	-14.29%	-17.42%	14.73%
Bangladesh	MSCI Bangladesh	4.71%	11.52%	1.25%	4.71%	11.47%	1.06%
Hong Kong	MSCI Hong Kong	-1.67%	-4.88%	10.03%	-1.67%	-4.87%	10.00%
	MSCI Zhong Hua	-8.03%	-14.75%	4.71%	-8.04%	-14.74%	4.68%
India	MSCI India	1.78%	4.96%	3.39%	2.48%	5.96%	5.02%
Indonesia	MSCI Indonesia	-4.58%	-8.94%	-15.74%	-3.19%	-4.97%	-7.97%
Korea	MSCI Korea	-8.03%	-16.96%	-7.58%	-3.52%	-9.35%	-1.61%
Malaysia	MSCI Malaysia	-0.37%	-11.55%	-9.70%	0.99%	-5.02%	-1.22%
Pakistan	MSCI Pakistan	3.58%	3.59%	4.07%	3.57%	3.69%	5.37%
Philippines	MSCI Philippines	-1.39%	-3.56%	3.37%	0.02%	-0.95%	5.69%
Sri Lanka	MSCI Sri Lanka	8.94%	5.32%	-6.93%	8.93%	5.70%	-5.10%
Taiwan	MSCI Taiwan	-7.01%	-9.94%	-2.15%	-4.85%	-7.16%	-2.25%
Thailand	MSCI Thailand	-7.68%	-10.91%	-8.54%	-3.66%	-4.74%	-2.02%
Vietnam	MSCI Vietnam	3.95%	10.56%	8.25%	3.85%	11.73%	10.43%
Global Emerging Markets							
Global Emerging Markets	MSCI Emerging Markets	-6.87%	-12.84%	-3.97%	-4.29%	-8.72%	1.26%
	MSCI Emerging Markets Small Cap	-7.69%	-11.51%	0.01%	-5.45%	-7.88%	4.48%

Region/country	Index/fund	US dollars			Local currency		
		MOM	3M	YTD	MOM	3M	YTD
Emerging Markets Europe Middle East Africa							
EMEA	MSCI EMEA	-4.65%	-10.34%	-0.74%	-1.18%	-4.74%	5.88%
	MSCI EMEA Small Cap	-2.47%	-8.35%	-4.79%	0.14%	-4.53%	3.04%
Czech Republic	MSCI Czech Republic	3.29%	-0.14%	4.06%	3.49%	0.00%	11.37%
Egypt	MSCI Egypt	-3.62%	-7.27%	-8.13%	-1.09%	-4.84%	0.61%
Greece	MSCI Greece	-0.84%	-4.87%	-26.16%	0.00%	-3.52%	-19.13%
Hungary	MSCI Hungary	4.91%	-3.54%	32.73%	3.24%	-0.73%	41.65%
Poland	MSCI Poland	-3.12%	-12.88%	-6.66%	-3.27%	-9.35%	-1.32%
Russia	MSCI Russia	-5.16%	-12.94%	21.16%	1.91%	-0.48%	22.78%
South Africa	MSCI South Africa	-5.81%	-11.19%	-3.27%	-2.09%	-6.28%	5.49%
Turkey	MSCI Turkey	-5.71%	-6.33%	-19.64%	-2.76%	-3.27%	-5.03%
Middle East							
Bahrain	Bahrain All Share Index #	-2.65%	-4.24%	-6.66%	-2.64%	-4.24%	-6.65%
Kuwait	Kuwait Stock Exchange Index #	0.55%	-2.41%	-7.50%	0.82%	-1.93%	-4.31%
	MSCI Kuwait	-0.97%	-6.12%	-5.78%	-0.82%	-5.80%	-2.62%
Oman	Muscat Securities Market Index #	2.07%	3.74%	3.39%	2.08%	3.73%	3.39%
Qatar	QE Index #	-3.41%	-3.15%	-4.07%	-3.41%	-3.12%	-4.07%
	MSCI Qatar	-3.96%	-7.04%	-7.84%	-3.96%	-7.01%	-7.84%
Saudi	Tadawul All Share Index #	0.13%	-7.48%	9.30%	0.13%	-7.49%	9.18%
UAE - Abu Dhabi	ADX General Index #	2.35%	4.03%	6.74%	2.35%	4.03%	6.74%
UAE - Dubai	Dubai Financial Market General Index #	1.38%	-2.03%	9.78%	1.38%	-2.03%	9.78%
	MSCI UAE	1.69%	-2.32%	6.59%	1.69%	-2.32%	6.58%
Israel	MSCI Israel	13.02%	12.57%	21.68%	12.78%	9.67%	17.70%
Jordan	MSCI Jordan	-0.23%	5.90%	-3.13%	-0.30%	5.95%	-3.03%
Latin America							
Latin America	MSCI Latin America	-8.35%	-13.92%	-14.05%	-2.39%	-5.28%	2.10%
	MSCI Latin America Small Cap	-6.79%	-13.14%	-19.70%	-1.36%	-5.03%	-5.74%
Argentina	MSCI Argentina	-10.03%	-21.24%	-2.81%	-10.03%	-21.24%	-2.81%
Brazil	MSCI Brazil	-12.21%	-19.59%	-19.74%	-3.59%	-8.54%	3.00%
Chile	MSCI Chile	-5.28%	-12.55%	-7.98%	-0.51%	-3.95%	1.87%
Colombia	MSCI Colombia	-9.80%	-19.80%	-24.52%	-0.86%	-4.51%	-9.25%
Mexico	MSCI Mexico	-2.53%	-3.03%	-4.04%	-0.48%	1.13%	4.31%
Peru	MSCI Peru	-8.34%	-16.48%	-13.16%	-8.34%	-16.48%	-13.16%

All performance are measured using total return except for those marked #
Performance are measured based on price performance
Source: Bloomberg, 31 July 2015

Global Emerging Markets Equity Team
Aberdeen Asset Management

Bloomberg data are for illustrative purposes only. No assumptions regarding future performance should be made.

For more information

Client Services Team
Tel: +65 6395 2701
Fax: +65 6632 2993

Aberdeen Asset Management Asia Limited
21 Church Street
#01-01 Capital Square Two
Singapore 049480
Tel: +65 6395 2700
Fax: +65 6632 2998
www.aberdeen-asia.com