# Market Update Note - Elizabeth Eaton

**Emerging Europe, Middle East and Greater Africa**

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**Overview**

- Emerging markets equities have sold off indiscriminately
- The fundamental case for emerging markets equities is sound
- The current environment is an opportunity to buy strong companies with good fundamentals and earnings visibility at very attractive prices

**We have seen considerable nervousness return to global markets in early 2008. Investors are concerned about the global economic outlook, together with issues about the quality of corporate debt. In this Market Update, we present the views of Elizabeth Eaton, a senior portfolio manager specializing in equities in Emerging Europe, Middle East and Greater Africa.**

As we have alluded to in previous updates, persistently weak credit market conditions, which have spread from the sub-prime crisis, have represented a near-term risk for emerging markets. Combined with recent announcements of disappointing economic data from the US and additional tightening measures in China, this has led to a fresh sell-off in global markets since the start of the year, as consensus has moved toward expectations of weaker US and global growth. As we have seen in previous bouts of risk aversion and higher market volatility, emerging markets equities have sold off indiscriminately, with virtually all sectors and regions hit hard in the correction.

While it is difficult to predict when the current environment will give way to greater stability, the fundamentals and valuation case for emerging markets is sound. Given the more uncertain outlook for US growth, investors are likely to focus on areas of earnings growth visibility and profit delivery within emerging markets.

## A developed market problem

While emerging equity markets have fallen, the current problems in financial markets are more a developed world issue than a developing one. While many developed economies have started 2008 on shaky ground, emerging market countries – almost across the board – come into the current turbulence with multi-year positive growth momentum, record levels of investment and portfolio flows and lower debt levels. Despite the liquidity crunch in the US, monetary policy remains accommodative in many parts of the world while strong external surpluses, high levels of central bank reserves and the growth in sovereign wealth and domestic pension funds offer new sources of liquidity for equity markets.

## Fundamentals remain in place

Despite recent events, the fundamental case for investing in emerging markets remains strong. The long-term structural drivers for growth are in place. Additionally, domestic demand and investment are stimulating economic growth from within, giving added insulation to economies across the region. While sentiment is certain to be affected by global uncertainty, we continue to see exciting opportunities in regional markets. We believe there are currently some great opportunities to buy strong companies with good fundamentals and earnings visibility at very attractive prices.

## Russia

Russia remains our top pick in the EMEA region, given the market's very attractive valuation relative to other markets, the strong outlook for domestic consumption and investment and the positive news on the political transition which has reduced market uncertainty. The country has obviously benefited greatly from high oil prices and while we remain constructive on underlying oil and gas prices, expect the Russian economy can still grow around 4.5 to 5% even with oil prices falling to around $45/bl.

Economic growth has diversified considerably and is no longer driven purely by exports. In terms of consumption and investment, Russia is growing even faster than most large economies in Asia.

Our portfolios are oriented to capture this emerging growth and we continue to find companies exposed to domestic demand elements highly compelling. Within the commodities space, we continue to differentiate companies with strong fundamental drivers outside of pure commodity price appreciation. For example, Gazprom, which continues to benefit from the restructuring of the Russian gas industry.

**Central Europe**

We continue to favour Poland and Czech Republic over Hungary, which continues to suffer from the impact of ongoing structural problems. While valuations for the CE-3 markets as a whole look less enticing than those elsewhere in global emerging markets, they continue to benefit from powerful pan-regional investment themes in the form of real estate, consumer and infrastructure spending. Poland, in particular, has experienced a sharp sell-off mainly due to increased nervousness in the domestic investor base. Redemptions from Polish mutual funds have been rapid with a marked impact on overall market performance. However, as valuation becomes increasingly compelling, we will seek out long term buying opportunities.

**Gulf markets**

These markets offer good value given the very strong growth dynamics and excess liquidity conditions resulting from high capital account surpluses which is fuelling a domestic capex boom. Regional markets held up well in the first weeks of the new year, but have not been able to escape the past week's sell-off. In general, companies have been delivering strong earnings and, at deeper discounts, we find the valuation compelling. This region will continue to generate increased investor interest over the course of the year.



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