Market Update
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Market Update Note - Neil Gregson and Annabel Betz

Emerging Markets Equity

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 from two of our senior emerging market equities team, who explain the current market background and give their outlook.

Overview

- Emerging markets equities have sold off indescriminately
- The fundamental case for emerging markets (particularly infrastructure) equities is sound
- The current environment is an opportunity to buy attractive companies in various infrastructure sub-segments and real estate

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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 - and emerging market infrastructure in particular - 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.

In our view, infrastructure-related equities offer some defensive qualities as they are less vulnerable to the global cycle. The improvement in fiscal balances within emerging markets over the past decade and greater macro stability have allowed governments to embark on infrastructure spending after severe neglect over the 1990s - a theme that did not go unnoticed by investors in 2007, as infrastructure-related sub-segments (construction and engineering, transport) began to outperform.

Expansion in ports, airports, highways, rail systems and power generation capacity is a multi-year phenomenon that will continue to support overall growth, regardless of the global cycle - and could even been stepped up as a countercyclical policy tool by many emerging market governments. In addition to these, area urbanisation will continue apace and will be a major driver of not only power and transportation demands but also the real estate sector.

Within emerging markets the real estate sector is now providing many great investment opportunities as while the stocks have shared the poor performance of their developed market counterparts the fundamentals are opposite, i.e. strong, and just at the start of long term trend in home ownership with prudent lending (high deposits)

We believe that the search for earnings visibility and profit delivery will continue to support the investment case for infrastructure-related stocks. As a result, we do not look at the current sell-off as a reason to panic, but as an opportunity to invest in companies in various infrastructure sub-segments where we see strong growth going forward and very attractive valuations.

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