

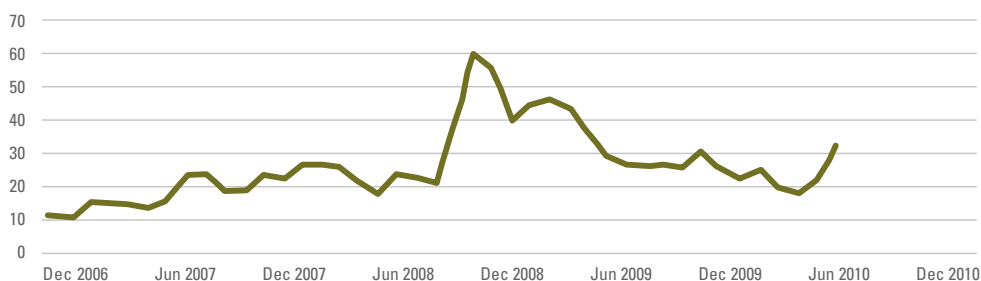
Latest insights: Emerging Market Equities

Esemplia Emerging Markets, a specialist Legg Mason fund manager, provides its latest insights in the Emerging Market equities asset class



Despite the backdrop of the continued recovery in global economic growth and increased resilience across most Emerging Market economies, we have seen a marked shift in investor sentiment during the early stages of this year. The change reflects a focus on issues such as the deteriorating debt dynamics and fiscal challenges in Europe, leading to questions around the long term viability of the Eurozone. These concerns dominated news headlines and resulted in heightened levels of volatility (though volatility is well below the high of 2008).

VIX Index



It is fair to say that, generally speaking, these concerns have no direct and in some cases even negligible impact on Emerging Markets economies, however they have been reflected in the performance of the asset class with the MSCI EM Index falling by 6.17% over the first 6 months of the year and over 15% during May before partly recovering to close at -8.80%. This comes at a time when the medium to long term prognosis of many Emerging Markets economies remains positive, as evidenced by their ongoing contribution to global GDP.

In terms of Emerging Markets economies, growth numbers continue to surprise on the upside. First quarter numbers for China (+11.9%), India (+11.2%) and Brazil (+9%) were all at levels higher than expected. In terms of Developed Markets, many larger developed economies such as the US, Germany, France and Japan also all continued to show a steady recovery trend in GDP growth over the first quarter of this year.



We take the view that the global cyclical recovery remains well entrenched, not only on the basis of the continued strong outlook for growth in larger Emerging Markets economies but also as several Developed Markets economies continue to show steady trends in recovery. While we recognise there are some risks which may impact the overall 'shape' of the recovery, we firmly believe there is very low probability of a scenario whereby we will again see negative growth in the broader global economy (that is, the chance of a 'Double Dip').

So what are the risks?

Whilst we recognise that there is significant 'sentiment' risk in the global equity markets (as indicated by the news headlines) which has the ability to impact security prices, particularly as trading volumes are at relatively lower levels than has been the case in recent years (causing a situation where prices are 'trading away from fundamentals'). We believe we would need to see the current debt crisis in the European periphery escalate to encompass some of the 'more sound' markets in the region. The result of such an event could be another freeze in credit markets, such as what was seen at the time of the collapse of Lehman Bros.

We do not view this as a likely event given we have witnessed and expect to continue to see:

- Bold fiscal consolidation and monetary support measures;
- Pro-active actions by the European governments (as we have already seen) to manage through this crisis; and
- Continued ability of the Emerging Markets economies to "weather the storm" via their ability to use their reserves / lower levels of indebtedness to continue policies towards "domestic growth"

FURTHER INFORMATION

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