



Outlook for Emerging Market Equities in 2010

Emerging markets equities posted a gain of 38.4% in 2009, partially recovering from the record loss of 41.2% in 2008. Over the medium term, we expect the strong fundamentals of the asset class to translate into healthy returns. In the short term however, we expect greater volatility, making a point forecast return even more treacherous than usual. In 2010, we believe several key factors will set the tone of global financial market returns and emerging markets in particular.

The most important factor is likely to be the removal of the quantitative easing put in place by the various central banks in early 2009. This was an extraordinary response to extraordinary times and on balance we believe it was justified. However, as growth returns to more normal levels and output gaps close, its removal will become increasingly necessary. It is difficult to ascertain the impact of the end of quantitative easings on market sentiment and liquidity but just as their implementation marked the turnaround of markets at the lows, their end, in isolation, can be seen as market negative.

Of course, nothing works in isolation, and this brings us to our second driver, the global economic growth outlook. For most emerging markets the picture is bright, as strong growth will continue to be underpinned by healthy domestic demand expansion, even in the face of sluggish consumption growth in the developed world. China, the largest emerging market, will continue to punch above its weight in terms of its contribution to world economic growth. We expect Chinese growth to clock in at around 9% in 2010, driven again by investment but increasingly also by consumption. China's exchange rate policy will also be important to watch as a depegging from the U.S. dollar will become increasingly central to prevent rising protectionist pressures in the west.

Corporate earnings growth should play another important role in supporting equity markets in general and emerging markets in particular. As we move into 2010, 2011 earnings forecasts will become essential to the formulation of the market's valuation assessment and it is possible that the current consensus expectations of may need to be adjusted down during 2010. It is too early to state a strong position here but we are cognisant that vigilance and close monitoring of this factor will be of utmost importance.

Last but not least, even after a year of stellar returns, valuation levels for emerging markets remain supportive. In conclusion, we remain constructive towards the prospects for emerging markets equities over the medium term, but with the expectation that the outperformance of the asset class versus developed market global equities in the coming year may be less dramatic than the level witnessed over the past year.

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