BLACKFRIARS ASSET MANAGEMENT

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Market Review

November returned to the prevailing negative trend that has characterised 2015 for GEM equities. The asset class slipped 3.9%, with 13/21 trading days being negative. All save three of the 23 constituent countries were down.

Asia was the most resilient region declining 3.3%. The heavy-weight trio of China, Taiwan and South Korea (49% of GEM) lost 3.4-3.5%, hampered by weak currencies. Malaysia was a regional stand-out, creeping up 1.2%. Latin America retreated 4.2% and Brazil was again negative, down 3.2%. However, it abdicated its usual position of laggard to Andean neighbours. Colombia plummeted 16.4% hit by crude oil weakness, with Brent blend shedding 10%. EMEA was the worst region, losing 6.2%. Hungary's 7.1% jump could not counter weakness elsewhere, especially Greece and Poland which plunged 25.2% and 10.8% respectively.

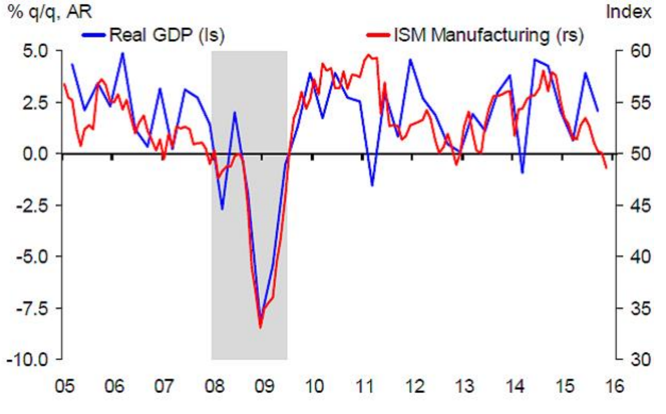
All sectors receded and materials was the straggler down 6.8%. This move was partially driven by Vale's mining disaster in Brazil. Information technology was the leader only losing 1.8%, buoyed by positive returns from TSMC and Tencent.

Argentina Elections

The opinion polls had pointed to a victory for Mauricio Macri who was viewed as being more market-friendly than the continuity candidature of Daniel Scioli. However, these polls had been unreliable in the first-round. The eventual Macri victory with 51.4% of the vote is not a ringing mandate for change. He also lacks a legislative majority. When he enters the Casa Rosada on 10th December he faces many daunting tasks, especially a two-tier foreign exchange system that he made a campaign promise to resolve. However, a depreciation of 50%+ will temporarily crash the economy. The market fell 10%, taking profit away from the previous 30% rally this year.

US Rate See Saw

As we move in to the final month of the year, the two key areas of market focus remain the same – US interest rates and the Chinese economy. What had become the consensus view of a 25bps rise in rates at the Fed meeting later this month has now been thrown in to doubt by a surprisingly weak manufacturing ISM number released yesterday (1/12).

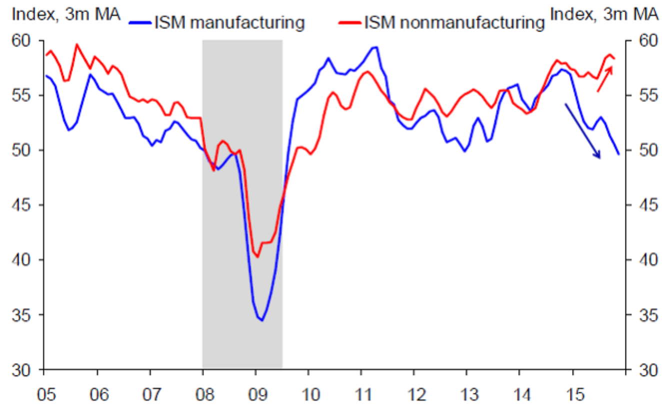


Source: BEA, ISM, Haver Analytics, DB Global Markets Research

For the self-confessed 'data led' Janet Yellen and fellow governors of the Federal Reserve Board this clearly throws in to question whether it is appropriate to raise rates when one of the most widely followed indicators points to recessionary conditions.

Our view is that the right thing to do (as has been the case all year) would be to begin to raise interest rates. QE has failed in its objective of stimulating the real economy and is merely inflating financial assets. However, our base case has been that the Fed would shy away from this potentially difficult course of action and keep rates on hold throughout 2015.

It is anybody's guess what their final decision will be. One factor which may allow Mrs. Yellen to overlook the recent ISM number is that manufacturing is now only 15% of the US economy and the service sector, which makes up the other 85%, seems to be doing just fine. We await the employment report and non-manufacturing ISM later this week with interest.



Source: ISM, Haver Analytics, DB Global Markets Research

Chinese confusion

The progress of the Chinese economy continues to fascinate the media, generating many hours of TV and innumerable column inches. Despite all this commentary, confusion reigns. The official GDP numbers show an economy gently slowing, but no-one believes this. The reality is that parts of the economy are slowing rapidly whilst other segments are still performing well. The task for the Chinese leadership is to ensure that the pace of deceleration of the 'old economy' is managed such that is does not cause financial stress to the whole system thereby allowing the 'new' economy to prosper and China to transition to a consumption led growth model.

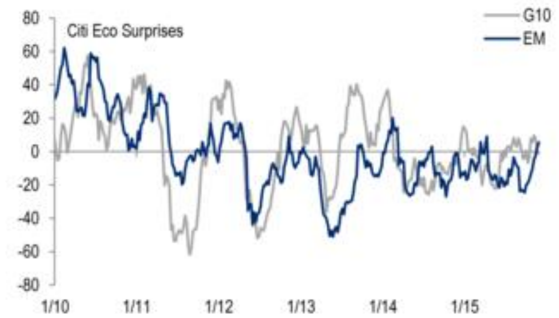
Thus, whilst it is difficult to be bullish on the Chinese market as a whole, it is distinctly possibly to find companies that are doing very nicely thank you (witness the recent statements by Apple and the like).

Market Roundup

For developing markets as a whole it has not been a good year. And against a backdrop of a strong USD driven by rising US rates combined with continued QE in Japan and the EU, the outlook is challenging. Bull markets in the dollar tend to go hand in hand with EM underperforming DM.

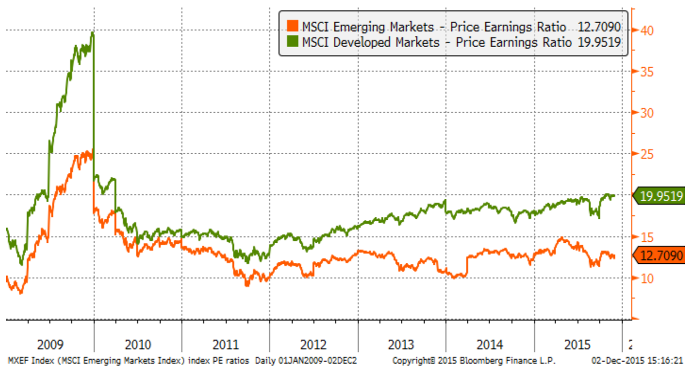
On the positive side, economic surprises have swung in to positive territory for EM while developed markets have moved in the opposite direction.

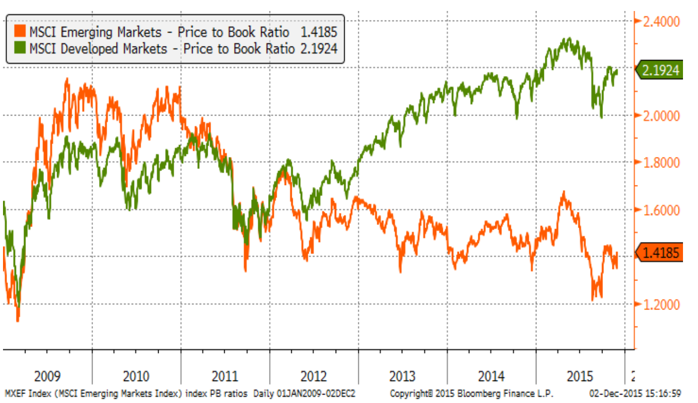
Please see over



Source: Bloomberg, Citi Research

Valuations are supportive but not yet compelling. Looking at both PE and PB ratios, emerging markets are trading at a discount to developed markets but not at historic lows.





Sentiment remains very weak and is reflected in continuing outflows.

Source: MSCI, Citi Research

So in aggregate we continue to see mixed signals from a top down perspective. Developing markets are not expensive and a lot of the negatives seem to be already priced in. However, until sentiment improves – and our crystal ball is a bit cloudy at the moment – it is difficult to see how there can be a wholesale rise across the asset class. In the meantime, as stock pickers, we are presented with a meaningful number of opportunities to own good businesses at realistic prices.