

Developing Markets Insight

MARKET REVIEW

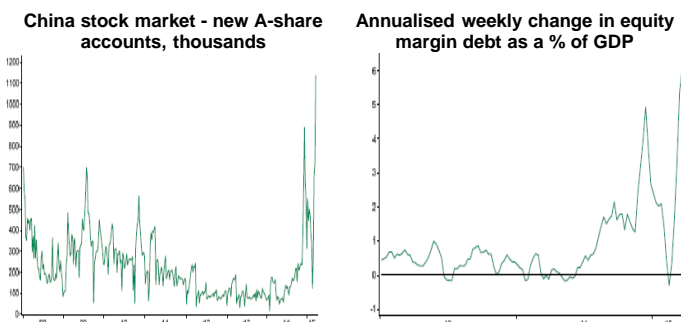
In March GEM recovered from an initial 5% decline, to register a more modest slippage of 1.4%. The recent trend of Asia performing positively, whilst Latin America and EMEA struggle, continued. China rose 2.4%, hitting a 7 year high, boosted by easing measures to stem slowing growth. The best market was Hungary, gaining 7.5%, as OTP Bank rallied on an improving outlook. Greece was the laggard, slumping 16.6%, as bailout talks tarried. Overall currency weakness, in the face of continued US dollar strength, was the main factor in returns. The leading sector was Healthcare, up 1.1%. Materials continued to be friend-less, slipping 5.3%. For the quarter GEM equities have risen 2.2%, keeping track with the developed world's 2.3% gain.

All returns above are stated in US Dollar terms.

FUN WHILE THE PARTY LASTS BUT IT WILL END IN TEARS

Chinese equity markets are in the news again. Following on from last year's 49% rise, the China's A-share bubble continues to inflate with the Shanghai Composite up 16% in the first quarter. The rise has been driven by exuberant, leverage-fuelled retail buying. With over 1.1 million new A-share trading accounts opened last week alone, margin debt in recent weeks has increased at an annualised rate of over 6% of GDP.

With A-share P/E ratios still comfortably below previous 2007-2008 highs, the retail buying frenzy and its margin debt counterpart can potentially continue for some. But the more P/E ratios are lifted by unsustainable leverage, the larger the ultimate correction.



Source: Macrobond, Bloomberg, BNP Paribas

ARE MY RENMINBI SAFE IN THE BANK?

Last week the Chinese Government announced that they will launch an insurance program that guarantees bank deposits. It will be similar to the Federal Deposit Rate Insurance Corporation in the US, launched in 1933 in order to prevent bank runs.

The details of the program are much as expected and will have limited direct impact on the bank's earnings (they will be taxed to pay for it but probably only around 0.02% of deposits). The program paves the way for interest rate liberalisation and this poses more serious questions for the market.

The insurance scheme will cover deposits up to Rmb500k (USD81k), which suggests 99.6% of deposit accounts are safe. Sounds great, but the problem with that is the other 0.4% hold around 50% of the total value of all Chinese bank deposits. If some of these deposit holders feel they need to move their money to a safer place then there could be a big problem leading to higher funding costs and potentially the risk of bank runs.

We continue to believe that the structural reforms being put in place are positive for the Chinese economy but negative for the profitability of the SOE's including the banks in the short to medium term.

We remain cautious on the overall growth dynamic in China. Over the course of the last couple of years this has become much a more of a consensus view with most investors now recognising the 10% GDP growth is no longer a realistic expectation. Overall we still feel that consensus is too optimistic with current consensus for 2015 at around 7% GDP growth. We expect to see 2015 develop in a similar fashion to 2013 & 2014, with short cycles of economic acceleration and deceleration but we remain wary of chasing more cyclical stocks as our expectation remains that the longer term structural trend is for slower growth.

As such we continue with a preference for companies where we see a medium term, structural growth story (eg increasing environmental awareness, 4G, everyday consumption) rather than the 'old' growth model of fixed asset investment (materials, property, banks).

NIGERIAN ELECTIONS: BAD LUCK JONATHAN

The Nigerian Presidential elections marked the first instance in recent Nigerian history when power between the Presidents was transferred through democratic peaceful elections and not military coup. Goodluck Jonathan, from Christian South, ceded power to Muhammadu Buhari, from Muslim North, marking the first transition of power from the People's Democratic Party (PDP) which has been incumbent since 1999. Pres. Muhammadu Buhari is not a newcomer to power, serving as 7th Head of Nigeria from 1983-1985 and who previously took power in a military coup d'etat. Markets expected volatile elections and the results to be disputed and there was therefore a positive reaction to the absence of both.

The upcoming challenges to Pres. Buhari are not new as Nigerian exports and government revenues are dominated by hydrocarbons, prices for which are down 44.5% since early 2014. Stabilising/raising production will require investment and stability in southern Nigeria, home to Nigerian crude, following Goodluck Jonathan's loss, who hails from the region.

Focus in the coming month will be on the upcoming elections for state governorships and assemblies. If the APC can repeat its performance, Nigeria will have perhaps the best prospects of economic reform it has had in years. The longer term investment case in Nigeria remains dependent on the level of oil prices and whether Buhari can rely on APC (a party united not in ideology but to oust the incumbent groups), as well as get the Nigerian South to support his policies and reforms. Hence, while Nigeria undoubtedly has turned a page to a brighter future, it still has a hard and volatile path to reach stable economic growth.

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