BLACKFRIARS ASSET MANAGEMENT

Developing Markets Insight

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MARKET REVIEW

In July GEM equities suffered a distinct reversal of fortune, with a fall of 6.9%. 19/23 countries were in negative territory. Latin America was the worst region, losing 8.4%, with Brazil the worst market, dragged down 12.2%, predominantly through currency weakness. Asia lost 7.2%, as China ran into turbulent profit-taking. EMEA was slightly more resilient, slipping 4.8%. Hungary was actually up 4.9%, whilst Greece was closed for the whole month, and therefore appears to be unchanged.

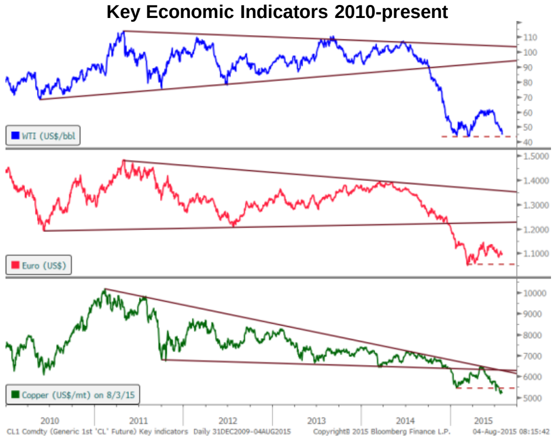
Health Care fell the least, losing 2%. The worst sector was Materials, down 9.2%.

US RATES

A key concern for developing market investors has been the potential increase in the US Fed funds rate and the knock on effect it will have on (all) markets. We have seen expectations for the timing of the Fed to make its first interest rate increase continually slip throughout the year, from March to June to now evenly balanced between September and December.

The Blackfriars view remains that we are unlikely to see any rate rise in 2015. Whilst it is possible that Mrs Yellen may make a move in September for political reasons, the breakdown of the three charts below suggest that rates stay down for a little longer.

Key Economic Indicators 2010-present

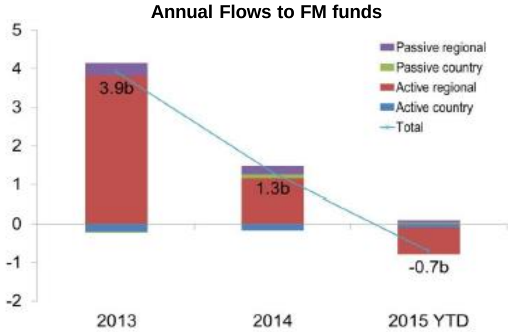


Source: Bloomberg

FRONTIER MARKETS

Investor interest in Frontier markets remains elusive. Since its peak in June 2014, MSCI Frontier has fallen close to 20% and investors have voted with their feet.

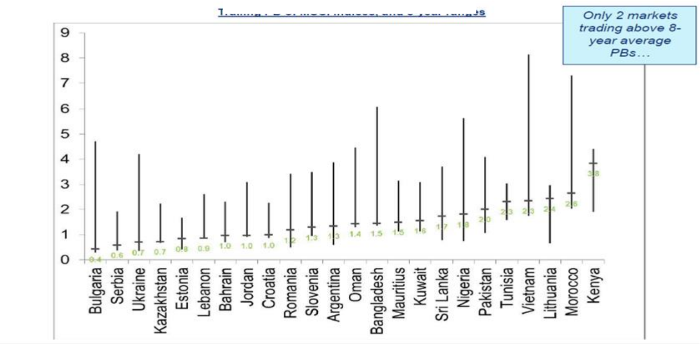
Annual Flows to FM funds



Source: EPFR

The declines we have seen leave many markets trading close to their P/B lows as shown on the chart.

Trailing P/B of MSCI Indices, and 8 year ranges

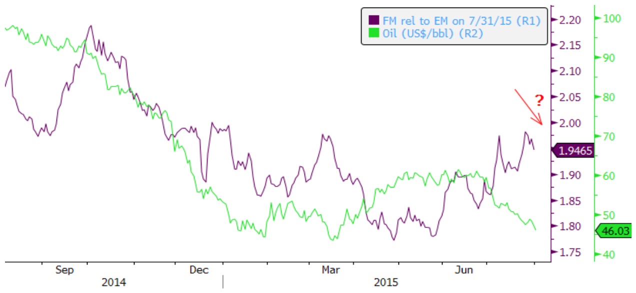


Source: CITI, Datastream

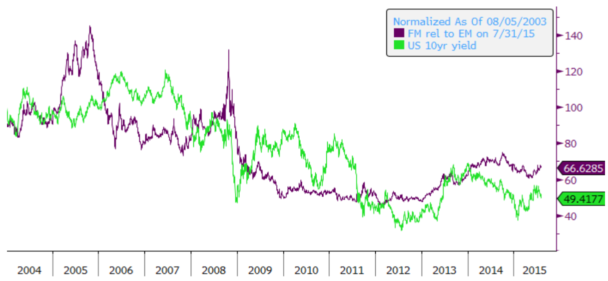
As the two charts below demonstrate, frontier markets tend to do better than emerging markets when the oil price is rising and when US yields are rising.

Frontier has been performing relative to emerging recently despite a sharp fall in the oil price but responding more to the positive trend in the US 10yr treasury yield.We are not positive on the outlook for the oil price and do not expect a surge in US yields any time soon. Thus we would not be in a hurry to add frontier exposure.

FM rel. to EM Oil



FM rel. to EM US 10yr yields



Source: Bloomberg

(P.T.O)

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TURKEY: THE PRICE OF BRAVERY

Turkey saw a significant increase in political risk after President Erdogan signed an agreement with USA and NATO to provide Turkish airbases for NATO strikes against ISIL and used Turkey's own air force to strike ISIL and PKK targets in Syria and Iraq. This development will have profound implications on the domestic security situation in Turkey as up until now the Turkish central government was quite tolerant toward ISIL supporters on its territory and for several years took steps to establish a peace process with the PKK. Now, President Erdogan may face not only ad hoc terrorist attacks by ISIL fighters within Turkish borders but is risking the return of all-out conflict with the PKK, an issue that has quietened over the past 5 years.There are serious concerns that President Erdogan is escalating these tensions to undermine the HDP (the leading Kurdish political party) and increase the AKP's share of Turkish nationalists' votes, indicating Erdogan's firm decision to push for a re-run of Parliamentary elections. While this strategy might bring short term gains to the AKP, we believe it will trigger a significant risk of increased terrorist activity on Turkey's territory, which is not priced in by the market currently.

GREECE: OPEN FOR BUSINESS?

Greece's stock market reopened after one month of "banking holidays" with both banks and non-financial stocks trading. While, as expected, Greek banks were very weak (limit down - 30% for most of the first session), non-financial stocks claimed back a significant part of their losses and closed on average 5-20% down. While at first glance this looks alarmingly weak, MSCI EM stocks on average lost between 4-12% in July (whilst Greece was closed) and the Greek non-financials correction could therefore be considered quite modest and controlled within the EM space. While we still expect quite weak performance in banks (until the end of August when the new bailout agreement between Greece and the Troika will be agreed), we expect the market to start differentiating between higher quality non-financials stocks (Motor Oil, Folli Follie) and weaker ones, and expect to see a divergence in performance.

PRICE FIXING

With the recent action by the Chinese authorities to prop up the stockmarket there we have another large slice of the world economy to add to the US, the Eurozone, Japan and the UK where central banks or similar bodies are manipulating prices. While not in any way condoning illegal rate fixing by market makers one can't help but feel a bit sorry for the recently convicted Tom Hayes and that the authorities are being slightly hypocritical . As James Grant said very eloquently in an FT commentary, "For an individual to fix Libor is a crime. For a central bank to suppress bond yields is an act of financial statesmanship."