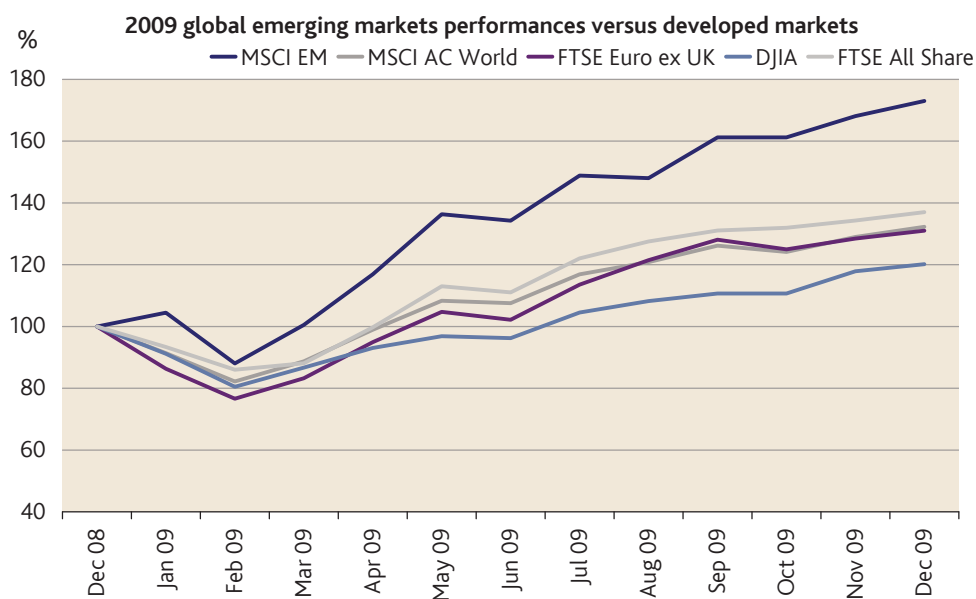




Emerging Markets Equities

Overview

Emerging markets overcame intense volatility in 2009 to end sharply higher amid the return of risk appetite. The MSCI Emerging Markets Index gained almost 80% in US dollar terms, led by Latin America and emerging Asia, far outpacing the performance of other asset classes. In comparison, the MSCI AC World Index returned about 35% over the same period.



Source: Bloomberg, 29 Dec 09

Stockmarket performance during the year reflected a sharp reversal in sentiment. Foreign investors initially fled from emerging equities as the panic sown by the failure of several major financial institutions in developed markets pushed financial markets close to collapse. Economic activity contracted sharply as lending froze. Demand fell, exports tumbled, and many emerging economies slipped into recession by early 2009. But sentiment turned around in early-March, after governments injected unprecedented amounts of liquidity into the financial system via fiscal stimulus and monetary easing. As fears that the world would suffer one of the deepest slumps since the Great Depression subsided, global markets bottomed in March 2009 and enjoyed an almost uninterrupted rally from then right up to the year-end.

On the economic front, collective government intervention appears to have stabilised the global economy and several countries are now expanding again, led by the emerging countries, prompting authorities to consider unwinding stimulus measures. Among the so-called BRIC economies, Brazil's GDP contracted less than the world's major economies in 2009; Russia's economy grew for two consecutive quarters after being hit hard by falling oil prices; China reported growth rates of around 9%, while India is forecast to expand by almost 8% in the fiscal year to March 2010.

Emerging Markets Equities

Outlook

Emerging markets may rally further amid flush liquidity in the short term, but loose monetary conditions and rising government indebtedness cast a pall over global financial markets in the medium term as these issues will eventually need to be dealt with. As a result, uncertainty and volatility are likely to persist and the outlook for 2010 remains opaque. However, the factors that will influence performance in 2010 are likely to differ from those in the preceding year, since we have moved past the worst of the credit crisis.

The foremost concern in the new year will likely be the sustainability of the economic recovery, unlike the depression fears of 2009. Most emerging economies returned to growth in the third quarter, helped by fiscal and monetary stimulus, while India and China avoided recession altogether. In Brazil, employment has climbed back to pre-crisis levels. In most developed countries, however, recovery has been tepid. US unemployment continues to linger near 26-year highs, while third-quarter corporate earnings have exceeded expectations only because of cost cuts. Ongoing deleveraging in the West may weigh on demand and limit export recovery in emerging economies. A double-dip recession cannot be ruled out. How developing countries will fare may depend on their ability to improve domestic demand.

Second, budget deficits have swelled because of bank bailouts and extraordinary fiscal stimulus. By its nature, such stimulus cannot continue for much longer. Funding concerns are growing and have political ramifications, with taxes set to rise. For now, policymakers appear to have decided that withdrawal would be unwise. The timing and strategy of exit will weigh heavily on markets nonetheless.

A related concern is the tightening of monetary policy. Israel has raised rates twice, the first emerging economy to do so, as recovery accelerated. It is possible others, having cut rates aggressively in 2009, will follow suit. Although the inflation outlook remains largely benign, there are pockets of rising price pressures. India will not escape the effects of its driest monsoon since 1972. Rising domestic demand in China, Brazil, Mexico and other developing economies with expanding young populations will also underpin commodity prices, though excess supply may mitigate such pressures in some sectors such as crude oil.

Third, the risk of asset bubbles is expected to become more pronounced if the rich world's recovery remains unconvincing, fiscal policy loose and interest rates near zero – conditions conducive for liquidity to continue flooding emerging markets. It is possible US interest rates will stay low for some time, restricting any recovery of the US dollar and prolonging the carry-trade. Developing world policymakers, however, are aware of the growing bubble risk and some have talked of strengthening capital controls, following Brazil's example. Maintaining exchange rate competitiveness also remains their main priority.

Problems that are unique at the country or regional level also prevail. The threat of political instability, a sharp rise in non-performing loans and defaults remain in Central and Eastern European countries, which had been more leveraged and reliant on foreign capital than their peers. Dubai's debt problems, and subsequent equity sell-off, underscores the still fragile state of credit markets and the potential for wider, perhaps catastrophic, effects in the event of defaults

Despite such concerns, we feel the inherent potential for emerging markets remains undimmed. Private and public finances are greatly improved and debt levels are generally low, giving further scope for stimulus if necessary. Easing government intervention and better institutional frameworks are allowing corporates to thrive. At this juncture, we see our stock-picking approach as especially relevant, given that earnings visibility has been obscured by the one-off effects of cost-cutting and inventory restocking. By contrast, our holdings, which we believe are well-managed and financially sound companies, should emerge stronger from the current headwinds.

Emerging Markets Equities

Important information

Issued by Aberdeen Asset Management Limited ABN 59 002 123 364 AFSL No. 240263 (Aberdeen). This is not an offer of securities or financial products. All offers of units in Aberdeen funds are made in the current Fund Product Disclosure Statement (PDS). You should consider the PDS in deciding whether to acquire, or to continue to hold units in the Fund. Anyone wishing to purchase units in our Funds should consider the PDS and complete the application form attached. Information in this document is based on sources believed to be reliable, and all opinions expressed are honestly held as at the applicable date. Subject to any applicable law, Aberdeen does not provide any warranty of accuracy or reliability in relation to such information or accepts any liability to any person who relies on it. Information in this document is of a general nature only and is not intended to provide investment or personal financial product advice. This document has not been prepared taking into account the particular objectives, financial situation or needs of any investor, so it is important that before acting investors should consider the appropriateness of the information, their own circumstances, objectives and financial situation and consult a financial and/or tax adviser. Aberdeen shall not be liable for any loss or damage caused to any person in respect of this information, except as required by applicable law. You must not copy, modify, sell, distribute, adapt, publish, frame, reproduce or otherwise use any of this material without the prior written consent of Aberdeen.

For more information

Client Services

Tel: +61 2 9950 2888

Fax: +61 2 9950 2800

Aberdeen Asset Management
Level 6, 201 Kent Street,
Sydney, NSW, 2001, Australia

GPO Box 4306, Sydney, NSW, 2001

www.aberdeenasset.com.au