

Investment Outlook for Fourth Quarter 2011

It is difficult to make clear predictions about the current global investment environment. During the closing month of the third quarter we have experienced a period of volatility, similar to that experienced during September and October 2008. This time, however, there is relatively little impact on the real economy and the flow of world trade and capital. There seems to be a 'disconnect' between Main Street and Wall Street; between the healthy, busy world which we observe, in which Asian companies and consumers are travelling, spending and building; and the frenetic, high frequency trading activity which now seem to dominate New York, London, Hong Kong and other capital markets. The recent UBS trading scandal appears centred on the misuse of Exchange Traded Funds, which is a worrying phenomenon. It is too early to say whether equity markets are reaching valuations which will provide an opportunity to purchase equity stakes in corporations, with healthy balance sheets and attractive dividend yields, but we feel confident that in the dynamic emerging economies in which our clients invest, that moment is near.

2012 is an election year in the US, France and other major countries which means the natural tendency of politicians will be to stimulate and to further monetise the growing government debt. This will eventually result in the dollar weakening and gold continuing its steady rise as the Chinese and other newly rich countries accumulate the metal.

Concerning the Euro, we take little comfort from the historical survival rates of currency unions, not also subject to fiscal integration. Such unions failed in Latin America in the late 19th century, and again in Europe in the early 20th century. The current inclusion of 17 European countries with disparate price levels and inflation rates has lasted longer than many pundits expected, but the eventual breakdown of such an artificial construct may free up countries to pursue more independent monetary policy and strengthen their exports. The UK after 1992 is a case in point. The impact on Asia however should not be dismissed as Europe represents a major market for China and other exporting countries.

China is experiencing some slowdown in its economic growth, both because of a slowdown in exports, but also because of the slowing of the country's infrastructure boom. The shift to a more consumer based economy cannot happen overnight and we still see some risk in the retail and consumer areas because of increased competition. Technology is one bright spot which we expect will lead the market in the recovery, both in Asia and elsewhere. In general we continue to expect that the Beijing authorities will be able to manage their economic transition successfully, as they have done in the last 30 years and that there will still be good investment opportunities in mainland China. Whether the A share market in Shanghai, which has disappointed in the last 12 months will reflect this economic strength is another question. Certainly earnings have been downgraded regionally, but this seems fully discounted in the share prices.

In India there is a continuing inflation problem and some concerns have arisen in the past two months, again about government corruption. The Indian market has been one of the weakest in our universe, and we believe that valuations are looking increasingly attractive in the pharmaceutical, software and consumer sectors. Much will depend on the oil price for these Asian countries especially India, Sri Lanka and South East Asia.

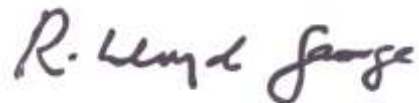
In Latin America we note a moderate slowdown in Brazil, but the recent fall in the Real may support export stocks. The copper price will continue to be a strong support to Chile and Peru and we have also been looking at Colombia for some investment opportunities. Our team is currently visiting Mexico because we see that market having been unduly oversold because of the close proximity to the US economy.

Our Frontier Market team has now started work and we are establishing our own Frontier Market fund, which will be diversified among Africa, Central Asia and other regions. Frontier Markets represent an attractively valued asset class that offers significant diversification benefits, and is likely to provide attractive returns to institutional investors.

In our strategy call today, we have concluded that the global economy may slow but will still show a 4% growth in 2012, and Asia around 5% regionally with China and India leading at nearly 8%. The markets are very oversold; earnings downgrades are in the share prices, and some Asian markets are within 10% or less of the post-Lehman 2008 levels with price to book at 1.1 times, and Price/Earnings at 10 or below. We expect a 30% rebound in global equities in the next four months. Commodities are more uncertain. Gold will resume its long-term trend after touching \$1,500; copper and iron ore are much more economically sensitive; and if China's steel production and electricity consumption slows, there will be weakness in industrial metals.

In our portfolio sector weightings, we emphasize consumer staples, internet stocks, telecom, some technology, and underweight financials. We are slightly overweight China/Hong Kong, neutral on India, cautiously overweight Korea, overweight Malaysia, and neutral on the rest of Asean, especially Thailand, which has done well. We are underweight Australia and Japan. Inflation in Asia is still high but should be peaking now with easier monetary policies and lower interest rates in coming months.

The key, as always, to investment markets is the balance between inflation and deflation. The recent letter from the Republicans in Congress asking Mr. Bernanke to stop debasing the dollar has had a salutary effect. The dollar has rebounded, and all commodities and currencies are down. How long will it last?



Robert Lloyd George
28th September 2011