EMERGING MARKETS MONTHLY REPORTS
FOR INSTITUTIONAL INVESTORS AND PROFESSIONAL ADVISORS ONLY

# Global Evolution

December 2011

## Emerging Markets Overview

December did not play out quite the way we had hoped for as Euro-area debt and fiscal policy worries continued to weigh on market sentiment. On the one hand the ECB actually did deliver as the bank relaxed collateral rules and announced 3-year LTROs on top of lowering the refi-rate by 25bps to 1.00%. On the other hand the outcome of the December 9 EU summit proved somewhat disappointing as the fiscal brakes to be adopted in national constitutions and the monitoring of compliance still needs approval by national parliaments with the outcome being far from certain. Also, the funding of the EFSF's and the ESM, with the latter decided to be brought forward to July 2012, remained somewhat unenthusiastic and unclear. Consequently, the door to ECB all-in quantitative easing remained closed leaving Italian yield spreads and interbank risk metrics close to recent record highs.

With one of the pillars behind our early December call to scale up risk being seriously weakened (the other pillar being the history of solid risk asset performance in December) and with the euro in retreat we were forced to reconsider our investment strategy not least in our blended funds. Nevertheless, the damage was done as local currency debt benchmark GBI EM Global Diversified went from a MTD plus 1.40% to MTD negative 2.50% in a matter of days. GBI EM Global Diversified finished the month down 1.47% with Eastern Europe being the worst performing region, down 4.04%. GBI EM Global Diversified finished the full year down 1.75% (against the dollar). Hard currency debt markets fared better in December thanks to a rally in US treasury bonds leaving US 10yr yields 19 bps lower in 1.88% by the end of the month. Hard currency debt benchmark EMBI Global Diversified returned a monthly 1.13% taking the annual return to a decent 7.35%.

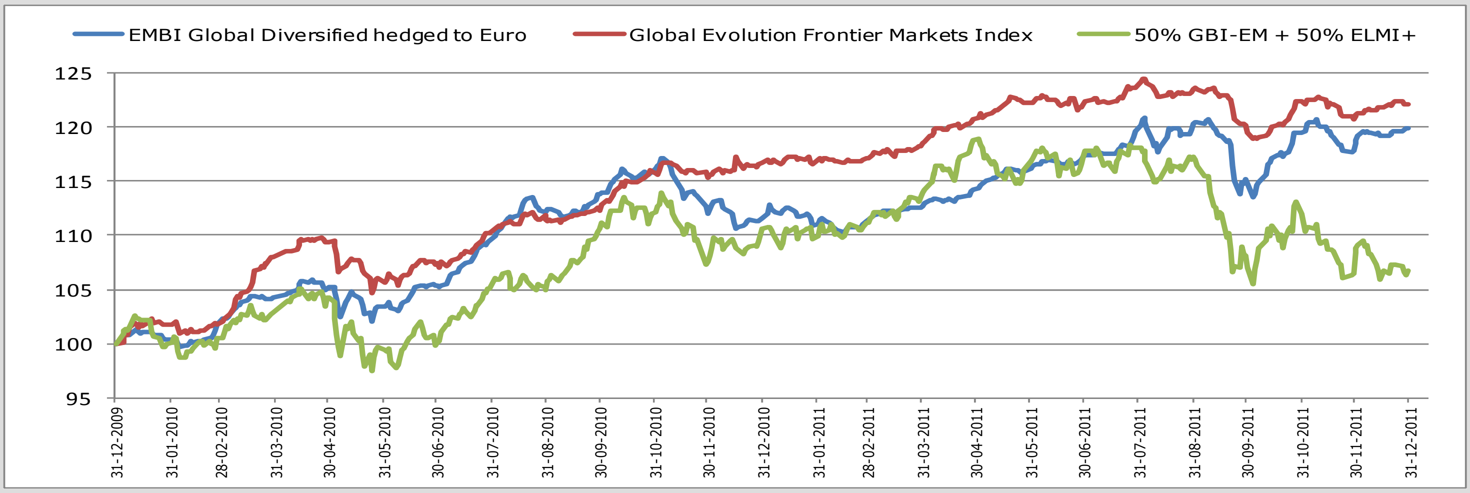
Elsewhere in risk markets, as the dollar gained strength gold lost its appeal leaving the glittering asset down 10.46% on the month. Germany's DAX stock index returned a monthly negative 3.13% whereas US S&P500 stock index gained a monthly 0.85% as US job market data as well as industrial/business data outperformed consensus expectations thereby fuelling expectations for better growth numbers in Q4 2011 and Q1 2012. WTI crude oil at some point during the month traded as low as USD 92.52 per barrel but managed a solid recovery to finish the month in USD 98.83 a barrel on the back of supply worries and Iranian rumblings in the strait of Hormuz.

In terms of portfolio flows the story in December was much the same as in November. Reflecting the dire outlook for global growth and not least the uncertain fate of the Euro-area, according to Emerging Portfolio Fund Research dedicated emerging markets fixed income funds suffered a monthly outflow of USD 611mn (0.5% of AUM) leaving YTD inflows at 5.6% of AUM. Local Currency funds saw monthly outflows worth 2.1% of AUM (up 11.1% YTD), whereas hard currency funds had a small monthly inflow representing 1.1% of AUM (up 2.6% YTD). Blended funds saw monthly outflows worth 0.5% of AUM (up 5.5% YTD)

## Investment Outlook & Strategy

The Euro-area sovereign debt crisis is bound to dominate headlines and market sentiment in weeks to come starting with the Merkel-Sarkozy meeting on January 9 and to be followed by a minister of finance meeting on January 23 and a full EU27 summit by end January. With no doubt a status on the agreed incorporation of fiscal brakes in national constitutions will rank high on the EU27 summit agenda. Other issues likely to dominate risk sentiment in January are EMU sovereign financing needs and the raising of capital by European banks struggling to meet the 9% core Tier 1 ratio by end H1. Banks are expected to test investors risk appetite already in January whereas EMU sovereigns will test the demand among fixed income investors with an estimated financing need worth about 220bn in Q1. According to ECB statistics the money is there as deposits with the central bank rose to a record high EUR 446bn as of January 2nd. A lot of those money will have to be put to work, but to what extend will EMU sovereign coffers benefit? Medium term and longer term we strongly believe that Emerging Markets fixed income will see an increase in crossover flows from G3 institutional investors previously focusing on core markets fixed income. However, short term much will depend on overall risk sentiment, legal considerations and solvency issues. As for emerging markets hard currency debt despite the many uncertainties the technical picture looks good as investors remain structurally underweight and as sovereign net issuance in 2012 is expected to be about flat with more than 33% of coupon payments and amortizations to hit the market in Q1.

The fact that Chinese PMI surveys recently have risen to expansionary territories and that business and consumer confidence in the US and the EMU are diverging with the former beating consensus expectations are clearly positives supporting commodities and risk assets in general. However, due to short term headline risk and from a risk/reward perspective, while we see decent value in emerging markets hard currency debt we are inclined to reduce exposure to crowded local currency debt not least in Eastern Europe.

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# Global Evolution Frontier Markets (Fixed Income)

| Performance in December (I-Share Class) | |
|---|---|
| Portfolio | **0.94%** |
| J.P. Morgan Next Generation Markets Index $ | -0.22% |
| EMBI Global Diversified hedged to euro | 1.13% |
| GBI-EM Global Diversified in dollar | -1.47% |
| **Fund Performance Attribution in December** | |
| Local Return (capital gains) | 1.16% |
| FX | -0.15% |
| Trading P&L | -0.07% |
| Total Performance | **0.94%** |
| **Performance YTD** | |
| Portfolio | **4.68%** |
| J.P. Morgan Next Generation Markets Index $ | 1.87% |
| EMBI Global Diversified hedged to euro | 7.39% |
| GBI-EM Global Diversified in dollar | -1.75% |

| Fund Specification | |
|---|---|
| Name: | Global Evolution Frontier Markets (Fixed Income) |
| Domicile: | Luxembourg |
| Legal Structure: | Open-end – SICAV – UCITS |
| Share Classes: | Institutional: I, Retail: R |
| Registered Countries: | Germany, Austria, Luxembourg, Sweden, U.K., Singapore and Denmark |
| SRI Fund: | Yes |
| ISIN: | I: LU0501220262, R: LU0501220429 |
| Bloomberg Code: | I: SXGFMFI LX, R: SXGFMFR LX |
| NAV: | I: 105.23, R: 102.96 |
| Fund Size: | €97mn |
| Benchmark: | No benchmark |
| Launch Date: | I: 15.12.2010, R: 19.01.2011 |
| Min. Investment: | I: €1mn, R: €300 |
| Base Currency: | EUR |
| Return Profile: | Accumulating (i.e. no dividends paid) |
| NAV Calculation: | Daily |
| Management Fee: | I: 1.00% p.a., R: 1.50% p.a. |
| Performance Fee: | 10% |
| High Water Mark: | Yes |
| Reporting: | Monthly |
| Contact: | em@globalevolution.com |

**Investment Objective**

The objective is to create attractive returns by utilizing a non-benchmark focused and diversified strategy within sovereign frontier emerging markets globally. The fund invests in hard currency and local currency instruments as well as foreign exchange.

| Top-10 Country Distribution | |
|---|---|
| Uganda | 4.95% |
| Serbia | 4.85% |
| Zambia | 4.81% |
| Ukraine | 4.67% |
| Nigeria | 4.65% |
| Venezuela | 4.13% |
| Tanzania | 4.05% |
| Dom. Rep. | 4.04% |
| Mozambique | 4.00% |
| Mongolia | 3.91% |
| Top-10 Total | 44.17% |

| Fund Data | |
|---|---|
| Portfolio Yield: | 11.93% |
| Portfolio Duration: | 4.27 |
| Number of Countries: | 33 |
| Average Portfolio Rating | B- |
| Hard Currency Instruments (hedged to euro) | 55.3% |
| Local Currency and FX Instruments: | 41.7% |
| Volatility 1 year: | 3.32% |

**Trades in the portfolio**

In December we took more duration in Mozambique by selling our bond maturing in February 2012 and buying the new 5 year MZN denominated bond issued on December 7. We definitely like the duration in Mozambique and the new 5 year bond will be more liquid since the central bank issued around MZN 2.6bn equivalent to USD 100 million and a large size by local standards. Given the size of the issue there were very good demand for the bonds and the auction was 3 times oversubscribed. In Ghana, by end December we had a local T-bond worth around 3% portfolio weight expiring without reinvesting the proceeds. Tactically, we hope for a better entry point to reengage in Ghana's local markets during January since local corporate dollar demand often take place early in the year. Consequently, as the Ghana exposure was not rolled it has lowered the portfolio YTM and raised the cash position above our normal threshold.

**Successful strategies**

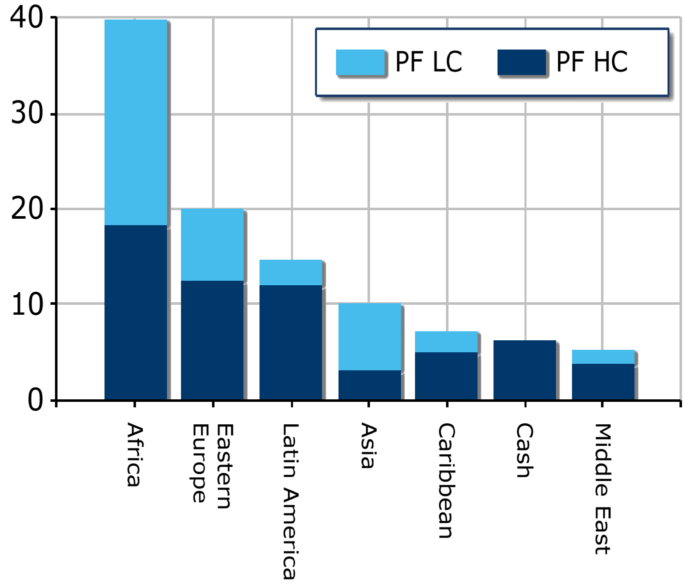
Uganda Shilling was one of the best performing currencies in December appreciating 4.85% against USD. As we entered December Uganda made up our single largest portfolio exposure close to the maximum 5% and Uganda actually proved our best performing country exposure in December thanks to the combination of FX-appreciation and carry. We like the position especially from a carry/duration perspective and stick with it for now although the currency may stabilize around current levels after a very strong 2011 year end performance. Elsewhere, the traditional high beta countries Argentina and Venezuela performed well in December. In the case of Argentina the announcement of Herman Lorenzino as the new minister of economy was well received by the market as it should not lead to further radicalization of economic policies. Uruguay did very well during December as the government announced a debt swap at very favorable prices. We switched from the 2018 inflation linker into a new 2028 inflation linker with a pick-up of almost 100 bps in real yields. We see Uruguay's inflation linkers as a very attractive carry play with real yields at 4.25% and annual inflation running around 6-8%.

**Less successful strategies**

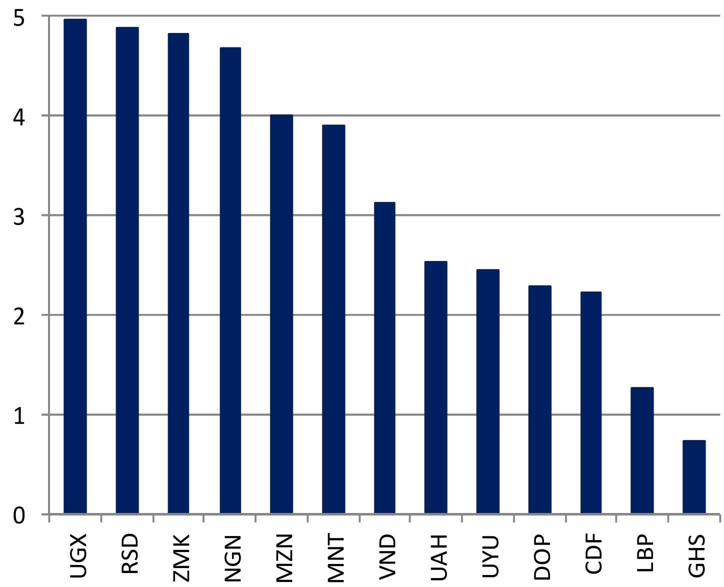
Mongolian Tugrik performed poorly in December losing more than 4% against USD. Apparently the depreciation was caused as rapid fiscal expansion this year pushing inflation to the mid teens forced some foreign investments to a standstill on fears that higher borrowing costs will cut the profitability of mining projects. In response the Mongolian government announced spending cuts in the 2012 budget which is certainly a step in the right direction. Despite the negative sentiment towards MNT in December S&P affirmed the country's BB rating and revised the outlook to positive from stable. Egypt's dollar denominated bonds lost another 5-6% in December as social unrest, an uncertain political environment and a deteriorating economy took its toll on market sentiment. In our opinion, most negatives are now priced into the dollar bonds and therefore the timing is not right for a "stop loss". Elsewhere, contagion risk especially from Italy weighed on Albania's euro denominated 2015 bond again in December. Despite the unavoidable slow down in Southern Europe we remain comfortable with the Albanian exposure. This is based on the fact that the rather closed Albanian economy was able to show decent growth during the difficult years in 2008 and 2009. Also, with Albanian yields above 11% we are paid adequately.

# Global Evolution Frontier Markets (Fixed Income)

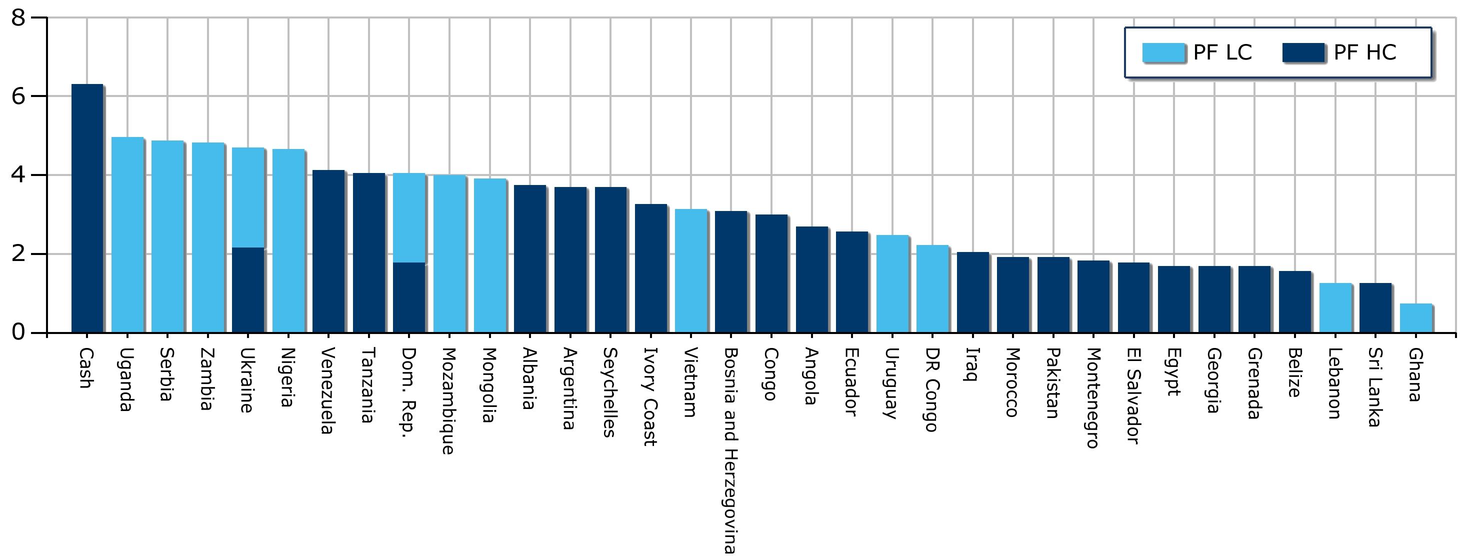
### Regional Distribution




### FX Distribution




### Portfolio Country Distribution




### Portfolio Absolute Return Contribution