GAM

Press release

GAM: Reforms in emerging markets driven by growing influential middle class

- Election results in Indonesia and India demonstrate the growing power and influence of the middle classes in emerging markets
- Upcoming elections in Brazil could result in a sharp drop in the cost of capital and a major re-rating of companies
- GAM Star North of South EM Equity celebrates its third anniversary. It is placed in the top decile and ranked 10th out of 400 funds in the Morningstar global emerging market equity category* over a three-year period

Comment from Matt Linsey, manager of the GAM Star North of South EM Equity fund:

London, 30 July 2014: A major emerging theme for emerging markets in 2014 has been reforms driven by pressure from the growing middle classes. Dramatic elections held in a number of key markets are one manifestation of that pressure, although it is important to differentiate the potential impact on the individual equity markets that constitute the region.

People power – the rise of the middle classes

India has seen the unprecedented victory of Narendra Modi, a man elected by a wide cross-section of society on the basis of his reform programme, rather than family background, caste or religion. This has transformative potential for the country, the economy and the stock market. Because many of India's problems are self-inflicted, a reform-oriented government with a strong mandate may resolve them. By cutting fuel subsidies, the country will resolve its deficit problems while returning profitability and growth to its energy companies. By cutting red tape, much needed investment in infrastructure can resume. State controlled enterprises will be run professionally, aiming for profit and growth rather than satisfying political objectives. With sensible policies, the high cost of capital should fall. The profitability of India's corporate sector should increase dramatically as a result, more than justifying the current market rally.

We have also seen a reformist presidential election victory in Indonesia. However, Jokowi's win was by a narrower margin than expected and his opponent Prabowo is challenging the result. Prabowo also controls Parliament and can effectively block reforms that the markets are expecting. Unlike in India, there is little state interference in the corporate sector and most companies are already well-run and profitable. It is harder to justify the market's high valuation in this situation, as risks remain substantial and the scope to improve corporate profitability is more limited.

Brazil and China

The next significant election will be in Brazil, where President Dilma's economic policies and interference in state-run companies have resulted in a collapse in economic growth and the profitability of state-controlled businesses. Like India, many of these problems are self-inflicted and could be resolved by a determined opposition candidate like Aecio Neves. His election could result in a sharp drop in the cost of capital and a major re-rating of companies such as Petrobras, which are being destroyed by current policies. However, it is not yet obvious whether the opposition will win. Despite a widespread middle-class revolt against Dilma, her status as the successor of President Lula still gives her significant support among Brazil's poor.

Finally, although the country does not hold elections, China is a crucial play on the reform theme. A new leadership was introduced last year and is under tremendous pressure to end corruption and waste, while rebalancing the economy. State-owned enterprises (SOEs), which make up 75% of the Chinese stock market, are at the forefront of this clean-up. Hundreds of managers and officials have already gone to prison and there is a real drive to reduce corruption at all levels. This has the potential to both improve profitability and valuations of SOEs, as well as leveling the playing field for the private enterprises that compete against them. Valuations in the Chinese market remain very low after years of underperformance. Although there is no election trigger, there is significant upside for many stocks if the anti-corruption drive continues.

GAM Star North of South EM Equity celebrates its third anniversary

The GAM Star North of South EM Equity fund is managed by North of South Capital and has generated a total return of 20.3% since inception on 25 July 2011** With an annualised return of 6.4% since launch, the fund has outperformed the benchmark, the MSCI Emerging Markets index which posted 0.8% over the same period. The fund had assets of USD 192 million under management as at 30 June 2014.

GAM Star North of South EM Equity seeks to achieve long-term capital appreciation through investing in a portfolio of emerging market equities. North of South Capital, a highly experienced emerging markets investment team, applies an active, value based approach combining top-down macro research and bottom-up company analysis to identify mispriced stocks, building a carefully diversified portfolio of typically 70 to 100 holdings.

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Notes to Editors

GAM

GAM is an independent, active asset manager and member of the GAM Holding Group. GAM delivers investment solutions to institutions, intermediaries, private clients and charities from offices in financial centres around the world. Its capabilities span investment strategies across equity, fixed income, absolute return, alternative investments, discretionary portfolio management and tailored investment solutions. Its aim is to deliver strong, long-term returns for its clients through some of the world's most talented investment managers. GAM's focus on performance, risk management, uncompromising investment standards and partnership with its clients enables it to achieve that objective. GAM Holding AG has assets under management of CHF 114.4 billion (USD 128.7 billion) [1] and employs over 1,000 staff with offices in 10 countries.

[1] *Source: GAM Holding AG as at 31 December 2013*

Past performance is not indicative of future performance. Performance is provided net of fees. These are the views of the manager at the time of writing.

* using oldest share class and excluding FoF and non UCITS, calculated on 30 July 14
**USD Institutional Share class, 25 July 2011 - 25 July 2014