Turkey benefiting from rise in domestic demand

Hopes of EU accession, government reforms and increasing domestic demand suggest an optimistic future for Turkey, despite the everpresent risk of political tension and spiralling government debt.

Since the financial crisis of 2001, Turkey has been slowly building up economic stability that is now beginning to look more sustainable.

In the three months to 30 July 2004, the country's ISE National 100 Index has returned 16.37% in sterling terms.

"We are cautiously optimistic for Turkey's future," says Glen Finegan, analyst for global emerging markets at First State Investments.

BULL POINTS

- Government reforms successful.
- Increasing consumer confidence.
- Strong equity market.

As a background to these improvements, Finegan points to reforms to standardise Turkish legislation as a stabilising factor for the country's economy. Amnesty International recently produced a promising report on the country, noting the improvement of human rights and removal of a ban on the Kurdish language, he says.

However, Finegan does express a need for caution due to the potential threat to the Islamic government from the powerful military. "They are a spectre in the background, despite changes that have tried to curb their power," he warns.

Following in this political vein, Neil Gregson, head of emerging markets for Credit Suisse, looks to the longer term and stability created by the possible accession of Turkey to the European Union. "Discussions will be held at the end of the year concerning Turkey's possible entrance into Europe," he notes. "This may increase investment interest, just as it did prior to the accession of the Eastern European countries".

Finegan agrees this is an exciting prospect for the country, as, at present, few large international companies are buying into Turkey and the economy needs to move away from its current heavily indebted position.

He says: "Recently, consumer confidence, and therefore domestic demand, has surged, resulting in high levels of imports and a subsequent increase in national debt."

However, Finegan points outs, growing consumer confidence has benefited the retail and banking sectors. He cites the growth of Acbank as a good example of this, as it specialises in consumer lending.

Looking across the whole market, Finegan argues, Turkey has a number of attractively valued companies that present a range of benefits for investors. Anadolu Efes, the largest brewery in the country, is not only benefiting from the rising demands of tourism but also has strong regional franchises in Russia, he says. "This investment allows us to invest in a well managed Russian company, which we may otherwise struggle to do," he notes.

Finegan and Gregson agree the strength of Turkish investment comes from the ability of many companies to ride out the political and economic volatility that has been explicit in recent history. Consequently, both managers underplay the danger of political tension in the Middle East affecting the market.

Clemmie Jackson Stops

BEAR POINTS

- Political tension still a threat.
- High level of debt.
- Middle East troubles could affect economy.

FUND MANAGER'S COMMENT |

China manages to secure soft-landing

The People's Bank of China (PBoC) appears to have pulled off the soft-landing many thought was impossible. It seems China's delicate balancing act, curbing excessive capacity in industries at risk of overheating while showing continued support for private consumption, is working.

"Many good quality growth companies are now trading on low valuations with transparent earnings"

Yang Liu, fund manager, Atlantis China fund

Over the past six months, China's stock markets have undergone a significant correction. MSCI China free fell 30% from its early January high but has already recovered 12% from its low in mid May.

The sell-off earlier this year was driven partly by stretched valuations after last year's China euphoria and fears of overheating, which would ultimately end in the Chinese authorities applying a significant brake to the economy.

All the signs so far suggest the PBoC has pulled off slowing the economy without stepping too hard on the brakes. The authorities have other tools at their disposal because of the Renminbi peg to the US dollar and were limited in their efforts to administrative methods to rein in loan growth.

In theory, the use of more market mechanisms, such as interest rate rises, would be required to achieve the desired soft landing.

The Government used heavy-handed tactics to avoid over-investment in at-risk industries. Government directives were to slow lending in areas heading towards overcapacity and to slow down raw material price rises.

This is difficult to administer and there were fears banks would interpret this as a halt on lending resulting in businesses outside the targeted areas having difficulty accessing working capital funds. The authorities were quick to see this happening and adjust their rhetoric accordingly.

As a result, we have seen a slowing of China's money supply growth. Total loan growth has declined – to 15.9% year on year in July compared to. 16.7% in June – and industrial output growth slowed for the fourth month in a row to 15.5% in July, down 0.7% from June.

For the first half, GDP still grew at 9.7% but, as industrial output contributes 40% of GDP growth, we expect a moderation in GDP in the second half of 2004.

CPI is a concern, at 5.3% in July, but this can mostly be accounted for by rising food prices and should be mitigated by an improved grain harvest this year. More encouraging is that stock valuations, in certain cases, are at levels similar to their Sars lows in March 2003.

Many commodities-related share prices have halved in the past six months but product-selling prices are only 10% from their peak.

A significant slowdown in earnings growth is anticipated in the second half of 2004 as a result of increasing raw material costs. Many good quality growth companies are trading on low valuations with transparent earnings, above market yields and have reported first-half earnings exceeding expectations.

China's long-term fundamentals are not in doubt. The country has accounted for a significant proportion of global GDP growth in recent years and yet is still chronically under represented in the global indices.

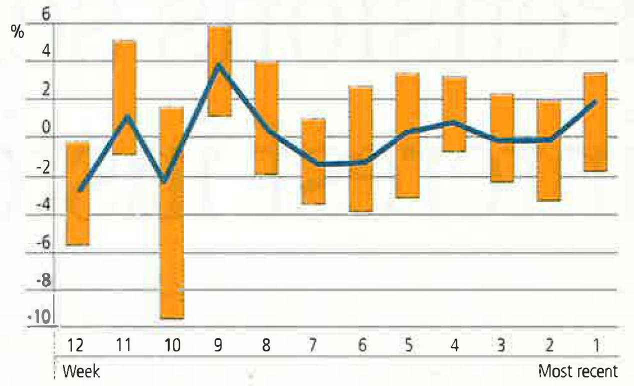
BULL POINTS

- Valuations looking attractive.
- Undervalued currency.
- Domestic consumption remains strong.

BEAR POINTS

- Margin squeeze for second half 2004 earnings.
- Rising oil prices.
- Cyclically dependent on the US.

SPREAD OF EMG MARKETS FUND RTNS WEEK BY WEEK



Source: Standard & Poor's

TOP/BOTTOM PERFORMERS OVER PAST 12 WEEKS

Bar	Top fund	Avg	Bottom fund
1	UBS Glbl Emerg Mkts Equity A	1.59	ISIS Pacific Growth SC1 Acc
2	First State Glbl Em Mkts LdrA	-0.10	Gartmore China Opps Rtl
3	Std Lf Asian Pacific Gth Rtl	-0.13	Baillie Gifford EmMkt A Inc
4	Baillie Gifford EmMkt A Inc	0.97	Jupiter Emerging European Opps
5	Investec Hong Kong & China	0.37	Credit Suisse Eur Front Rtl
6	F&C Em Mrkt Ex Pac-Asia Eq	-1.27	Solus Eastern Enterprise
7	Baillie Gifford DAsiaP A Acc	-1.27	INV PERP HK & China Acc
8	Gartmore China Opps Rtl	0.49	Jupiter Emerging European Opps
9	Fidelity South East Asia	3.77	CS M-Mgr Asia Pac Ptfl Inc
10	Jupiter Emerging European Opps	-2.67	Gartmore China Opps Rtl
11	Gartmore China Opps Rtl	1.18	Solus Eastern Enterprise
12	Templeton Glbl Emg Mkts A Acc	-3.35	Fidelity South East Asia

EMG MARKETS FUND SECTORS: RTN VS VOL OVER ONE YR

Source: Standard & Poor's

EMERGING MARKETS FUND SECTOR VOLATILITY

	One year return	Total year volatility	Total assets (£m)
Global Emerging Markets	4.2	2.4	3104.2
Far East Excluding Japan	-1.9	2.3	7148.9

GLOBAL EMERGING MARKETS – ONE-YEAR CONSISTENCY

Rank in sector		S&P fund rtng	1 year gain/ loss	1 year max loss	1 year % chg	1 year vltlty	Min initial invest (£)	Latest fund size (£m)
1	◀ Jupiter Emerging European Opps	A	1.57	-12.66	24.34	2.51	500	100
2	◀ Aberdeen Emerging Mkts A Acc		1.32	-11.95	11.67	2.11	500	127
3	new SWIP Emerging A		1.19	-13.88	7.18	2.34	25000	408
4	▼ JPMF Emerging Markets A Acc		1.19	-13.28	6.54	2.23	3000	59
5	▼ Credit Suisse Eur Front Rtl		1.28	-15.70	11.36	2.53	1000	15

Floating Chart Discrete Weeks – For each discrete period the highest and lowest performance achieved by a fund investing into this region/asset has been computed. The longer the length of the bar, the greater the range of performances over the time period. Use this table to compare the performances of the region/asset over different discrete periods. The top and bottom fund name as well as the average performance is identified in the table above. **Sector Scatter Chart** – The scatter chart illustrates the average performance and volatility over a 1-year period of those sectors that are invested in this region/area. The size of the square indicates the assets invested in the sector – small, medium, or large. Use this chart to identify those sectors that provide the highest return for the lowest risk. See top left hand quadrant. The sectors shown on the right hand side have historically been riskier. **Consistency Table 1 Year** – For details of the methodology used, see page 37.

STANDARD & POOR'S

Bid to bid, net income-reinvested
Lump, Cash, Init £100.00
Volatility measured over one year.
Please refer to the footnote on page 37 for how Standard & Poor's fund rating is determined

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