Monthly outlook – February 2011

Gábor Orbán – Re-emerging

The first capital-market topic of this year was the calming of the mood of panic that had arisen in relation to the debt struggles of the eurozone's periphery. Due to the holding of some extreme positions, this resulted in a decline in Spanish, Greek, Irish and Portuguese CDS premiums throughout January. The Hungarian market has followed the fluctuations of the periphery almost by proxy in the past as well, so that Hungarian assets clearly outperformed this January, prompting a minor correction in February.

Investors' attention has now turned from the debt crisis problems of European states to another process, namely the struggle of an ever-expanding number of developing economies against the influx of capital, moreover through only partly market-compliant means. Following Southeast Asia, Brazil and then Turkey began to draw investors' appetite away from building positions. There are a variety of reasons for such restrictions on capital: arresting foreign currency appreciation, putting a brake on the outflow of domestic credit, and preventing the formation of bubbles on various niche markets or the general overheating of the economy. Open market intervention, the raising of reserve requirements and all manner of taxes are among the frequent methods. In the "most successful" Turkey, the action taken was to introduce a changing system of requirements for reserves placed at the central bank, which favours the influx of longer-term over shorter-term capital. In addition the key policy rate was cut back in order to make Turkish investments less attractive for foreigners, all with the undisguised intention of introducing short-term volatility in asset prices, which in turn holds back the influx of capital. The result: a sharply weakening Turkish lira and suffering stock-market index …

In this context investors in emerging markets have effectively liquidated a significant portion of their positions taken so far, as a consequence of which their earlier overweighting of 43% has shrunk back to the March 2009 level of 5%. Unusually, all this did not occur due to a decreasing avoidance of risk, given that global investors have held the level of equity investments in their portfolios at a level higher than any seen in the past 10 years. Instead, outflowing funds were targeted at equity investments on developed markets, prices of which have risen since November on the back of low volatility. In addition, equities on developed markets also profited from investors' turning away from developed market bonds; the shine has been taken off the latter due to loose fiscal and monetary policy, while also growing stale in recent times as a result of the strong economic upturn and rising prices of raw materials. The "safe haven" status of the government bond market in developed economies seems to have been partly lost, as sometimes, when the appetite for risk is decreasing, investors do not find this class of asset a sufficiently attractive alternative.

In this environment, emerging markets acquire an attractive value, and may prove particularly appealing when the positioning of investors is modest and/or not overly burdensome, or when these markets can even profit from an increase in raw material prices. This category includes Russia, Brazil and the Asian market, and – by dint of its high valuation – the Turkish market as well, together with "virgin" territories such as the Balkans and the CIS markets.

Hungarian assets may also find renewed impetus in the wake of the resurgence on emerging markets, particularly because Hungary is not struggling against a capital influx and has not

recently featured among the preferred destinations of foreign investors. The domestic bond market as a whole continues to be underweighted, what is more even among domestic investors. Since the beginning of the year, the stock of government securities held by foreigners has increase by HUF 250 billion. At the same time, the Government Debt Management Agency has sold only HUF 200 billion in bonds, while significant coupon payments of HUF 200 billion have provided further ammunition for potential buyers. CDS contracts guaranteeing Hungary's national debt remain at a considerably higher level than the country's credit rating would justify, but there are no signs at present of a deterioration to be expected in this regard. While the 2011 budget, despite the somewhat runaway figures of the 2010 version, promises to be managed smoothly, the main concerns relate to the ensuing years, so that everything revolves around guesswork over the upcoming reform package. The HUF 250 billion stabilization fund announced for 2011 is an encouraging sign from this point of view, even if it is implemented based on the "lawnmower principle", because it indicates that the government is committed to its undertakings in the convergence programme.

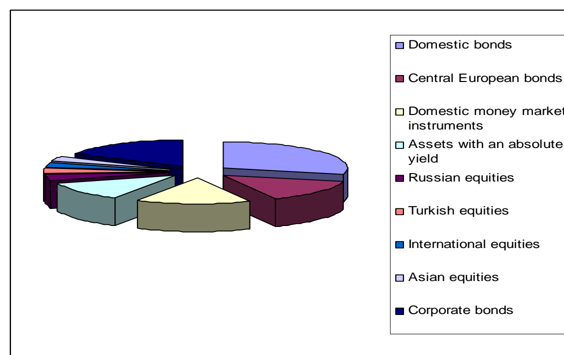
Recommended portfolio:

In the present market environment, AEGON Fund Management regards the composition of the portfolio below as ideal, offering potential steady performance with a medium risk profile:

Sample portfolio (February 2011)

Assets	Weight
Domestic bonds	29%
Central European bonds	14%
Domestic money market instruments	15%
Assets with an absolute yield	12%
Russian equities	4%
Turkish equities	3%
International equities	3%
Asian equities	3%
Corporate bonds	17%

Source: AEGON Fund Management



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