THE BRIC OUTLOOK IS STILL BRIGHT

The booming economies of Brazil, Russia, India and China show no signs of slowing down in 2007. BNP Paribas Asset Management, which oversees more than $30bn in emerging market securities, looks at how the markets will develop and why 'BRIC' isn't just a marketing concept

Having registered a stellar performance in 2006, Brazil, Russia, India and China (BRIC) have posted remarkable advances so far in 2007, and should continue to benefit from a helpful international environment provided US activity decelerates only moderately.

As pointed out by Martial Godet, head of New Markets Investments at BNPP AM, who oversees more than $30bn in emerging market securities, BRIC economies should continue to benefit significantly from their integration into world markets. Indeed, a slight dip in growth at this point would help avoid overheating, and to that extent, would actually be welcome.

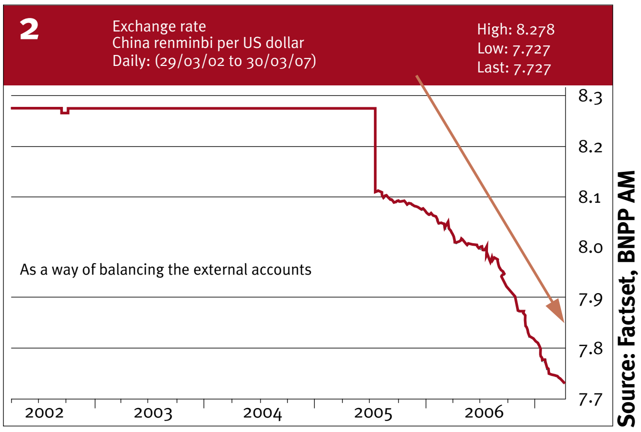
Most BRIC governments have been actively encouraging domestic consumption through tax incentives measures. A large middle class has been emerging, and with it, growing affluence and ever stronger domestic consumption. This in turn has reduced the dependence of emerging market economies on export revenues.

We at BNP Paribas expect BRIC economies to continue to grow by eight per cent on average in 2007, with some possibility of positive surprises if growth exceeds expectations.

Emmanuel Collinet de la Salle, Emerging Market Product Specialist at BNPP AM, says: "Allocation towards emerging markets should also continue as investors look for diversification opportunities and increasingly consider emerging markets as a mainstream investment."

BRIC should also continue to benefit from the persistence of abundant liquidity and cheap financing. This does not mean that they will not experience periods of high volatility, as they did last February.

1 Area	China	India	Latin America	Russia/ Eastern Europe
	Head of investment teams: Martial Godet			
Portfolio managers	Claude Tiramani Paris (France)	Chakri Lokapriya London (UK)	Jacopo Valentino Sao Paulo (Brazil)	Claude Tiramani Paris (France)
Local support	SYWG BNPP AM Shanghai Fund managers: 2 Analysts: 5	Sundaram-BNPP AM Chennaï Fund managers: 3 Analysts: 4	BNP PAM Brasil Ltda São Paulo Fund managers: 1 Analysts: 6	



PARVEST BRIC – A UNIQUE MODEL

BNPP AM's Parvest BRIC continued to gather assets (now at $250m) and to record strong returns, thanks to active allocation (the benchmark weighs equally Brazil, Russia, India and China) and stock picking. The management of the portfolio draws on the expertise of our central and local teams (see chart 1).

In particular, together with BNPP AM's subsidiaries and partnerships in BRIC, we strive to ensure that the funds make the most of the economic development of these countries and the emergence of local middle classes and domestic industries and services.

BNPP AM's organisation is the result of continuous investments in the emerging world. Max Diulius, head of BNPP AM New Markets, says: "The joint ventures between BNP Paribas Asset Management and our various partners have greatly strengthened the competitive edge of local asset managers, while providing BNP Paribas AM with in-depth insight in these new markets."

DYNAMIC COUNTRY ALLOCATION

BRIC occupy different positions in the economic cycle. They also present some differences in the development of domestic demand, and in their exposure to commodity prices. Accordingly, the portfolio is dynamically allocated across the four countries. The country allocation changes are based on a combination of quantitative and fundamental views. While the quantitative models forecast long-term country allocation trends on a monthly basis, the fundamental views of country specialists allows us to arrive at a country allocation on a monthly basis.

PROFIT GROWTH JUSTIFIES VALUATIONS

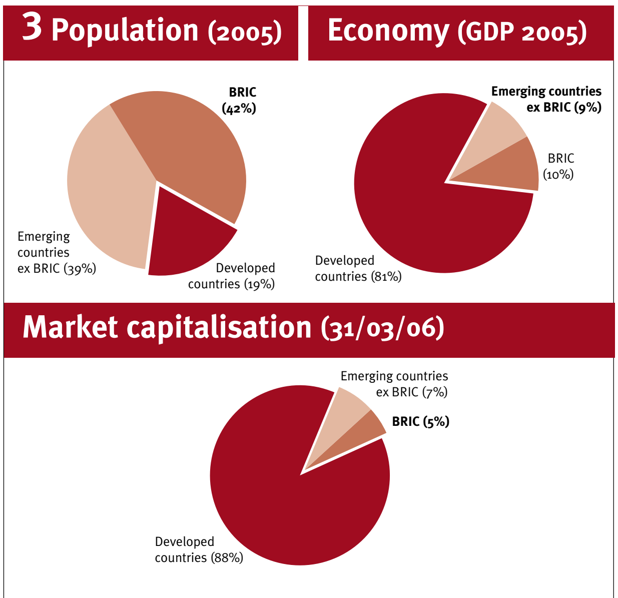
Despite some recent volatility, developing countries should continue to perform strongly and to offer good investment opportunities in the medium to long term.

Though valuation and liquidity remain key issues, BRIC does not suffer from equity bubbles: price-to-earnings ratios are still reasonable and trade at a 10 per cent discount to those of developed markets, as against a premium 10 years ago. In addition, most emerging market companies are much more profitable than they were only five years ago (return on equity of Chinese companies has tripled from five per cent to more than 15 per cent).

The main challenges remain the pace of growth and the risk of rising inflation. However, we feel that local governments and central banks are now well aware of the risks associated with stock market bubbles, and will act to avoid shocks to their economies to ensure the stability of their currencies and the smooth development of local financial markets.

The recent decision by Chinese authorities to allow domestic investors to invest abroad is a decisive step towards convergence between Chinese domestic stock markets and Chinese stocks listed in Hong Kong, and, more generally, other emerging markets.

However, as noted by Claude Tiramani, who manages $4bn of Chinese equity at BNPP AM: "The case for Chinese investment is a matter of conviction. If you believe in the comparison between Japan in the 1960s and China today you should consider investing for the long term. Those who invested in the Chinese funds we launched in 1995 and who were patient multiplied their investment 11 times."



Emerging stock markets still do not reflect the weight of their real economies

Source: IMF, ONU, Bloomberg

"The development of sophisticated products will enable investors to find solutions that reduce the impact of market corrections"
Martial Godet

THE CURRENCY BET

We also note the strong appreciation potential of emerging market currencies. This is an important part of the expected return of investments in these countries and a major reason to in vest in BRIC countries (see chart 2).

The recent strength of the Brazilian currency, which finally broke 2 BRL to $1, is an example of the contribution of FX to performance. Thanks to the appreciation of the Indian rupee, the performance of Indian stocks is much more impressive in dollars than in local terms (11 per cent compared with two per cent in 2007 as of 15 May 2007).

STRATEGY FAVOURS BRAZIL AND CHINA

We still have positive views on Brazil and China, which remain attractive. China has good economic prospects, despite a possibility of overheating, and attractive valuations (for Hong Kong-listed stocks). We are also positive on Brazil as years of structural reform have given rise to good growth prospects, and the central bank is in the process of cutting interest rates.

In China, the tightening measures enacted throughout the year have succeeded in curbing money supply and loan growth. Despite the rapid accumulation of dollar reserves, the Chinese have reaffirmed their reluctance to broaden the RMB fluctuation bands, as expected.

“Allocation towards emerging markets should continue as investors look for diversification opportunities”

Emmanuel Collinet de la Salle

Brazilian growth should continue to be supported by the better state of corporate health as well as good domestic consumption which should benefit from a decline in interest rates. Household demand is boosted by consumer credit. The Brazilian central bank has some leeway to smooth the impact of the US slowdown in Brazil. Interest rates have continued to decline steadily, and the BRL has continued to appreciate. Inflation remains under control.

BRIC: A MARKETING CONCEPT?

BRIC funds have erroneously been described as a pure marketing product. But each BRIC has its own distinct strength. Brazil and Russia are commodity-intensive, China is the world’s manufacturing hub, and India serves as a centre for services and high-end manufacturing.

By 2009, a 300-million-strong, innovative and skilled middle class in India will have emerged. And by 2015, the BRIC middle class with an urge to splurge will have expanded to 800 million, forming the basis of sustained expansion. They will greatly increase spending on essentials such as cars, consumer goods, and healthcare to support 43 per cent of the world’s population.

Capital markets innovation and discipline, essential for economic growth, will lead to the creation of larger banking companies. Early signs are evident, with a 50 per cent increase in the market capitalization of the financial sector in the BRIC countries since 2000 (see chart 3).

This demonstrates that BRIC is a pure product that focuses on the emerging superpowers rather than diluting fund returns by including other smaller emerging countries. BRIC strongly outperformed global emerging markets over the past three years.

BRIC is a powerful phenomenon, and it appears that they will emerge as superpowers much earlier than current estimates, generating significant investment returns as a result. Hence the idea that BRIC is merely a marketing concept is unfounded.

A THREE-STEP PRODUCT RANGE

The Parvest BRIC fund has a central place among other BNPP AM emerging market funds because it gathers the best of each teams based in Paris, London and local sites. It reflects the main positions of country funds and has a pivotal position within the product range as being the most diversified fund (see chart 4).

BNPP AM has organised its product offering for international investors to provide them with investment solutions that range from country to global funds, with large portfolios. In most cases, they present a small bias towards mid caps and domestic firms that would benefit from local development, while slightly underweighting energy stocks that can be purchased through other investment vehicles. Some structured products based on these funds are also available.

As Martial Godet says: “Innovation is still at the forefront of emerging market fund management. The development of sophisticated products and solutions including CPPI and structured funds based on emerging market underlying portfolios will also enable investors to diversify the risk profile of their holdings and find solutions that reduce the impact of market corrections.”

Thus, BNPP AM provides imaginative investment solutions for retail networks, private banks and pension funds.

4	Main countries	Capitalisation size	Number of holdings	Tracking error limits	Currency
Global Emerging					
Parvest BRIC Equal weighted MSCI (Brazil, Russia, India, China)	Brazil, Russia, India, China	Large and mid	130-150	6 – 10%	USD
Regional					
Parvest Latin America MSCI Latin America 10/40*	Brazil, Mexico, Chile, Argentina, Colombia	Large and mid	60-80	3 – 5%	USD
Parvest Converging Europe Nomura Central & Eastern Europe ex Russia	Poland, Hungary, Czech Republic	Large and mid	40-60	4 – 6%	EUR
Parvest Emerging Markets Europe MSCI Emerging Markets Europe 10/40*	Russia, Turkey, Hungary, Poland, Czech Republic	Large and mid	50-70	4 – 6%	EUR
Countries					
Parvest China MSCI China 10/40*	China	All caps	80-100	6 – 10%	USD
Parvest India MSCI India	India	All caps	60- 80	5 – 8%	USD
Parvest Turkey Istanbul Stock Exchange 100 Index	Turkey	All caps	30-40	5 - 8%	EUR
Parvest Brazil MSCI Brazil 10/40	Brazil	All caps	30-50	5 - 8%	USD

* Benchmark complying with the 5/10/40 diversification rule (max 10% for each stock and holdings representing more than 5% of the benchmark cannot add up to more than 40%)