

EM central banks tackle moderate inflation

By Gustavo Medeiros

Inflation was stable across EM in July at a much lower level than in the US. In contrast with the Fed, most EM central banks are increasing policy rates to anchor inflation expectations. Economic activity was softer than expected in China. Inflation peaked in Brazil while inflation expectations rose in India. The Mexican president said he may use the proceeds of the SRD injection by the IMF to repay sovereign debt. The Polish Parliament approved a controversial law banning foreign control of broadcasters. In Peru, Julio Velarde accepted another term as central bank governor. Malaysia eased mobility restrictions for vaccinated individuals. Colombia's economic activity was stronger than expected. Russia's trade surplus and the Philippines remittances had the best result for the month of June in the series. Turkey kept its policy rate unchanged and Uruguay hiked its policy rate more than expected. Zambia's opposition candidate Hakainde Hichilema won the presidential election. The civil war intensified in Ethiopia.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	12.5	–	-0.84%
MSCI EM Small Cap	11.7	–	-2.03%
MSCI Frontier	11.7	–	1.12%
MSCI Asia	13.7	–	-1.21%
Shanghai Composite	11.6	–	1.70%
Hong Kong Hang Seng	8.9	–	1.19%
MSCI EMEA	10.0	–	1.41%
MSCI Latam	9.6	–	0.12%
GBI-EM-GD	5.01%	–	0.21%
China GBI-EM GD	2.97%	–	-0.51%
ELMI+	3.08%	–	0.00%
EM FX spot	–	–	0.27%
EMBI GD	4.91%	355 bps	-0.22%
EMBI GD IG	3.08%	166 bps	-0.16%
EMBI GD HY	7.05%	573 bps	-0.28%
CEMBI BD	4.27%	311 bps	0.14%
CEMBI BD IG	2.93%	179 bps	0.03%
CEMBI BD HY	5.87%	470 bps	0.26%

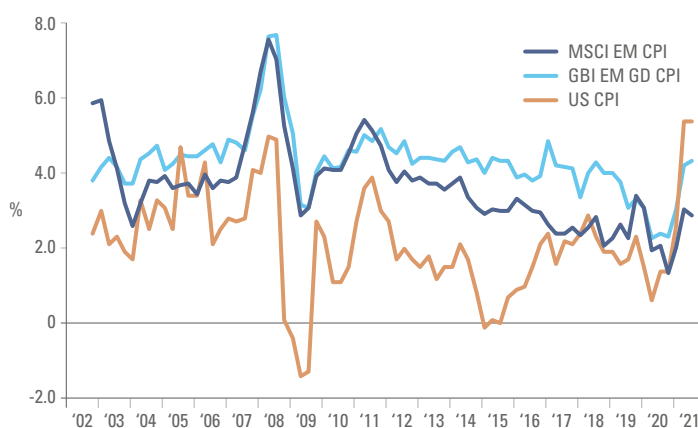
Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.4	–	0.75%
1-3yr UST	0.20%	–	-0.01%
3-5yr UST	0.75%	–	-0.04%
7-10yr UST	1.26%	–	0.18%
10yr+ UST	1.91%	–	0.46%
10yr+ Germany	-0.48%	–	0.37%
10yr+ Japan	0.65%	–	-0.20%
US HY	4.11%	309 bps	-0.16%
European HY	3.09%	346 bps	0.07%
Bloomberg-Barclays	1.02%	-24 bps	0.17%
VIX Index*	15.45	–	-0.70%
DX Index*	92.56	–	-0.39%
EURUSD	1.179	–	0.38%
USDJPY	109.40	–	0.80%
CRY Index*	217.0	–	2.48%
Brent	69.7	–	0.88%
Gold	1,773	–	2.69%
Bitcoin	47,468	–	2.40%

Note: Additional benchmark performance data is provided at the end of this document. *See last page for index definitions.

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EM inflation update: Inflation was broadly stable across EM in July. The yoy rate of CPI inflation in local currency bonds rose 0.1% to 4.3%, while the CPI inflation in EM equities was down 0.2% to 2.9% as per Figure 1.¹ US inflation was also unchanged, but at a more elevated 5.4% yoy, remaining above EM inflation for the fourth consecutive month. Lower inflation numbers in Saudi Arabia, China and India were the main drivers of the decline in MSCI EM inflation while higher inflation in Brazil, Mexico, Czech Republic and Turkey led the GBI EM GD weighted CPI inflation higher (but still slightly below its peak in May 2021).

Fig 1: EM (MSCI EM and GBI EM GD) weighted CPI inflation vs. US CPI inflation



Source: Haver Analytics, JP Morgan, MSCI, Bloomberg, Ashmore as at July 2021.

¹ Local currency bonds CPI weighted by the JP Morgan GBI EM GD Index. Equities CPI weighted by MSCI EM.

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In contrast with the Federal Reserve, which has been comfortable with higher inflation, most EM central banks have moved to a much more hawkish stance in order to contain inflation expectations. Last week, Peru and Mexico hiked their policy rates by 25bps to 0.75% and 4.5% respectively while Uruguay hiked 50bps to 4.5%. The decisions were more hawkish than consensus expectations in Peru and Uruguay, while the split vote in Mexico suggests a more dovish tone. After the hikes, the GBI-weighted EM policy rates increased to 3.0% last week, from 2.4% in October 2020. This increase is in line with higher EM sovereign yield: The GBI EM GD index rose to 5.0% from 4.5% over the same period. The yield of 10yr Brazilian government bonds crossed the 10% threshold again – a very attractive level both in absolute and relative terms to its peers.

Two-thirds of the EM countries in the GBI Index are either in the middle of a hiking cycle or are likely to increase policy rates in the near future as per Figure 2. Brazil signalled another 100bps at the next meeting, Russia is likely to hike another 50bps, Uruguay, Peru and Chile's tightening cycles just got started, while Hungary and the Czech Republic signalled further rate increases. Mexico is the least hawkish of the group after a split decision to hike the policy rate by 25bps last week. Inflation is uncomfortably high in Colombia, Poland, Romania and Dominican Republic while South Africa may opt for a pre-emptive hike in order to anchor inflation expectations.

Three countries are likely to keep their policy rates unchanged due to a combination of low inflation and Covid-19 mobility restrictions (Indonesia, Malaysia and Philippines) and three countries may cut rates in the near future. Thailand is the most likely candidate for a one-off 25bps cut to 0.25% followed by Turkey where the central bank is yet again under political pressure to ease.

China is likely to adopt targeted fiscal easing and a liquidity injection via reserve requirement, but may opt to cut policy rates, should economic activity deteriorate more than policymakers expect.

Fig 2: **Monetary policy cycle by country**

Hiking	Brazil	Russia	Uruguay	Chile	Peru	Hungary	Czech Rep.	Mexico
Will likely hike	Colombia	Poland	Romania	S. Africa	Dom. Rep	–	–	–
Stable	Indonesia	Malaysia	Philippines	–	–	–	–	–
Stable, may cut	Thailand	Turkey	China	–	–	–	–	–

Source: Ashmore. Data as at 16 August 2021.

China: Economic data was softer than expected in July. The yoy rates of retail sales, industrial production (IP), and fixed asset investment declined to 8.5% (from 12.1%), 6.4% (from 8.3%) and 10.3% (from 12.6%), all lower than consensus expectations (consensus). Aggregate finance came in at CNY 1.06trn, lower than consensus at CNY 1.70trn as the monetary M2 declined to a yoy rate of 8.3% in Jul from 8.6% yoy in June. Steelmakers have to provide greenhouse gas (GHG) emissions data to the Iron and Steel Association preparing for inclusion on the Chinese emission trading system. Steelmakers accounts for close to 15% of total GHG emissions in China. Baowu Steel said production curtailments in the coming months “is a political issue with no room for bargaining, and it must be resolutely implemented”. In other corporate news, Evergrande confirmed it is looking to dispose of its electric vehicle and property management assets in order to cut debt.

Brazil: The yoy rate of CPI inflation rose 0.6% to 9.0% in July, while producer price index (PPI) inflation dropped 1.2% to 33.4% yoy, both in line with consensus. Whilst inflation is likely to be peaking, in our view, the minutes of the monetary policy committee had a hawkish tone as Central Bank Governor Roberto Campos Neto pledged to “do whatever is needed to anchor inflation expectations” in a presentation to market participants. In other news, retail sales declined 1.7% in June after rising 2.7% in May (revised from +1.4%), broadly in line with consensus. Lastly, economic activity index rose 1.1% in June from -0.6% in May, slightly higher than consensus. In political news, Congress voted down a constitutional amendment to re-impose paper ballots. Brazil was one of the first large democracies to implement a safe electronic voting system.

India: A survey by the Reserve Bank of India (RBI) showed 1-year inflation expectations rising to 11% in July from 10.7% in May – the highest level since September 2016. Inflation expectations are one of the best leading indicators for inflation and the RBI will have to anchor inflation expectations below 12% in order to avoid inflation moving to much higher levels. The yoy rate of CPI inflation declined by 0.7% to 5.6% in July and PPI inflation declined 0.9% to 11.2% (both below consensus). The trade deficit widened to USD 11.0bn from USD 9.4bn, in line with consensus. In a positive development for long-term investment, Prime Minister Narendra Modi said India was cancelling a retrospective tax across a few industries in order to strengthen business trust.

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Mexico: President Andres Manuel Lopez Obrador (AMLO) said Mexico might use the proceeds of the SDR injection by the IMF (USD 12bn) to repay debt, since Mexico has enough FX reserves. However, a central bank governor challenged the president, as the government cannot use FX reserves to repay public debt. In other news, the yoy rate of CPI inflation declined 0.1% to 5.8% in July, in line with consensus, but the bi-weekly CPI inflation of late July rose 0.1% to 5.9% yoy, or 0.1% above consensus. IP declined 0.5% in June from 0.1% in May.

Poland: Congress approved a controversial media law that forbids direct and indirect control of broadcast news by companies outside the EU, Iceland, Liechtenstein and Norway. The Law & Justice party has turned public broadcasters into mouthpieces of the government while state owned companies stopped advertising in media companies that are critical of the ruling party. In other news, the yoy rate of CPI inflation was unchanged at 5.0% and the yoy rate of GDP growth rose to 10.9% in the Q2 2021 preview, from -0.9% in Q1 2021, both in line with consensus expectations.

Peru: In a positive development for macroeconomic stability, Central Bank Governor Julio Velarde agreed to stay at the helm of the Central Bank of Peru for another term. Velarde is a well-respected seasoned central banker, who will be instrumental in providing an institutional anchor to the Castillo government. In other news, Finance Minister Pedro Francke pledged to present a new mining tax proposal to congress this year.

Malaysia: The government lifted mobility restrictions for fully vaccinated individuals as it plans to vaccinate the entire adult population by the end of September. The yoy rate of GDP growth rose to 16.1% in Q2 2021 from -0.5% in Q1 2020 and the current account surplus improved to MYR 14.4bn from MYR 12.3bn over the same period, both coming above consensus.

Russia: The trade surplus rose to USD 18.7bn in June from USD 10.2bn in May, significantly above consensus and the best result for the month of June in 20 years of data. Exports rose USD 9.1bn to USD 43.9bn and imports rose only USD 1.0bn to 25.6bn. In other news, the yoy rate of GDP growth rose 10% in Q2 2021, in line with consensus, from -0.7% in Q1 2021.

Philippines: Remittances from Filipinos working abroad rose to USD 2.6bn in June, the best result for the month since the inception of the series. Real GDP contracted 1.3% qoq in Q2 2021 (-1.1% consensus) from 0.7% in Q1 2021 (revised from 0.3%), as the yoy rate of GDP growth was 11.8%, (0.9% higher than expected) due to the previous quarter revision.

Colombia: The yoy rate of retail sales rose to 24.7% in June from 22.8% in May, 4.1% above consensus expectations while IP rose to 13.8% yoy from 6.4% yoy and manufacturing production rose to 20.8% yoy from 8.5% yoy over the same period. In other news, the trade deficit widened to USD 1.6bn in June from 1.0bn in May, slightly wider than consensus expectations.

Turkey: The Central Bank of Turkey kept its policy rate unchanged at 19.0%, in line with consensus expectations. The CBT signed a 3-year swap agreement equivalent to USD 2bn with the Bank of Korea (BOK) in order to provide financial stability and allow trade flows. The deal has no impact on Turkey's foreign exchange (FX) reserves. In economic news, the current account deficit narrowed to USD 1.2bn in June from USD 3.2bn in May, in line with consensus expectations. In other news, floods in the Northwest killed more than 50 people according to disaster management officials.

Uruguay: The central bank hiked policy rate by 50bps to 5.0%, 25bps more than consensus expectations. The monetary policy committee stated that its priority, absent a deterioration of the pandemic situation, is to drive inflation to the centre of its inflation target at 4.5%. Indeed, more policy rate hikes are likely necessary to anchor expectations as the latest survey with market participants showed 24-month inflation expectations at 6.4%.

Zambia: The Electoral Commission declared the opposition candidate, Hakainde Hichilema, the winner of the presidential election with 2.81 million votes, against 1.81 million for incumbent President Edgar Lungu. Hichilema said he plans to agree on an IMF deal and start debt-restructuring discussions.

Ethiopia: Prime Minister Abiy Ahmed called all eligible civilians to join the country's army in the fight against the Tigray People's Liberation Front (TPLF). The TPLF offensive now encompasses the larger and strategic Amhara and Afar states; Ahmed's call for a full mobilisation suggests the conflict is likely to be protracted.

Emerging Markets

Snippets:

- **Angola:** The ratings agency S&P affirmed Angola's sovereign rating at 'CCC+' with a stable outlook. S&P sees a balance between large external funding requirements and low short-term funding needs after bilateral loan restructurings led to reduced debt service. The rating is excessively low, in our view.
- **Chile:** The trade surplus narrowed to USD 0.6bn in July from USD 1.1bn in June as imports rose faster than exports.
- **Czech Republic:** The yoy rate of CPI inflation rose to 1.0% in July from 0.5% yoy in June, in line with consensus, but PPI inflation rose to 7.8% yoy, 1.0% above consensus. The current account moved to a CZK 12.8bn deficit in June from a CZK 7.2bn surplus in May, CZK 9bn wider than consensus.
- **Ecuador:** President Guillermo Lasso's approval rate increased to 73.5% according to a recent Cedatos' poll.
- **Egypt:** The tourism industry will benefit from direct flights from Russia to the Red Sea, which resumed last week after a six-year travel ban. In other news, the yoy rate of CPI inflation rose 0.5% to 5.4% in July.
- **Ghana:** The yoy rate of CPI inflation rose to 9.0% in July from 7.8% yoy in June, 1.1% above consensus expectations, mostly due to higher food prices.
- **Hungary:** The yoy rate of CPI inflation declined to 4.6% in July from 5.3% yoy in June, 0.2% lower than consensus.
- **Indonesia:** The government eased mobility restrictions in Jakarta and three other major cities, while extending measures in different areas for another couple of weeks.
- **Kenya:** The Treasury expects the fiscal deficit to narrow to 5.6% of GDP in the fiscal year of 2022/23 from a target of 7.5% of GDP at the current fiscal year.
- **Namibia:** The yoy rate of CPI inflation declined 0.1% to 4.1% in July.
- **Pakistan:** In a direct challenge to the Washington troop withdrawal from Afghanistan, Prime Minister Imran Khan said the US finds Pakistan "useful to clean up the mess in Afghanistan." Over the weekend, the Taliban took control of Kabul forcing rushed withdrawals of US staff and troops by helicopter.
- **Rwanda:** The ratings agency S&P affirmed Rwanda's sovereign credit rating at B+ with a negative outlook, which was justified by a slower recovery post Covid-19 pandemic.
- **Romania:** The yoy rate of CPI inflation rose to 5.0% in July from 3.9% yoy in June, 0.6% higher than consensus. Wage inflation declined to a yoy rate of 7.4% in June from 9.8% in May. Industrial output rose 0.3% in June from -8.4% in May while industrial sales rose 5.8% from -1.7% over the same period.
- **Saudi Arabia:** The yoy rate of CPI inflation declined by a whopping 5.2% to 0.4% in July after the end of the impact of the VAT hike in 2020. Excess capacity in several sectors, including housing, kept inflationary pressures at bay.
- **Sri Lanka:** Foreign exchange (FX) reserves declined sharply to USD 2.8bn in July from USD 4.1bn in June. The FX reserve loss exceeds the USD 1bn Eurobond repayment last month, while the government expected to recover around USD 200m from local investors holding the repaid Eurobond.
- **South Africa:** Manufacturing production disappointed, declining 0.7% in June (+0.5% estimates) even though May production was revised by +0.6% to -2.0%.
- **South Korea:** The unemployment rate declined to 3.3% in July from 3.7% in June, lower than 3.8% consensus. The surprise was mostly due to a 0.3% drop in the participation rate to 62.7% as employment rose 542k in July from 582k in June.
- **Taiwan:** The yoy rate of exports rose 34.7% in July, from 35.1% yoy in June and 33.4% yoy consensus.
- **Thailand:** Real GDP growth rose by a soft 0.4% on a qoq basis, leading the yoy rate up 7.5% in Q2 2021 from -2.6% yoy in Q1 2021, 0.9% ahead of consensus expectations. The strong yoy number is due to a low base in Q2 2020.
- **Tunisia:** The government vaccinated 551k people (4.2% of its population) in a single day after receiving 6 million vaccine doses, displaying the ability of many low-income economies to vaccinate its population if the supply ever reaches the country.

Global backdrop

Covid-19: New daily cases continue to increase in the US, but the growth rates of both cases and deaths (second derivative) have declined for the fourth consecutive week. Furthermore, the positive test rate has also peaked; all suggesting cases and deaths may be peaking in the US. In the United Kingdom, 75% of the adult population has received two jabs of the Covid-19 vaccine. Germany announced some mobility restrictions for adults who have not been fully inoculated (unvaccinated adults will only be allowed into public indoor areas (such as restaurants and cinemas) if they present a negative Covid-19 test). Cases remain stable at a low level in India as the country vaccinated 5 million individuals per day last week which means close to 50% of its population has now received at least one vaccine shot. Israel and Chile have announced the administration of booster shots. In our view, large developed countries should refrain from purchasing third shots to focus instead on supplying vaccines to low income countries, until the majority of adults are double-jabbed on a global basis, in order to prevent new Covid-19 variants.

United States: The US Senate approved the USD 1.2trn infrastructure package with 69 votes against 30 as 19 Republican senators voted in favour of the bill. The package has USD 550bn of new money deployed over 10 years in broadband, electric vehicle charging, roads and mass transit. It also pays for 3-4 years old childcare and raises corporate tax by 7% to 28%. On the same day, the Senate approved a USD 3.5trn budget blueprint in a 50-49 vote held at 4am on 10 August.

In economic news, the number of job openings (JOLTS) reported by the US bureau of statistics rose to 10.1 million in June from 9.5 million in May, surpassing consensus by 800k. The rate of employees quitting their jobs rose to 2.7%, close to the highest level since 1999 as layoffs remain at all-time lows. The JOLTS data suggests pent-up demand in the labour market with more job openings than unemployed looking for a job. The yoy rate of CPI inflation was unchanged in July at 5.4%, 0.1% above consensus, while CPI ex-food and energy declined 0.2% to 4.3% (in line with consensus). The yoy rate of PPI inflation rose to 7.8% in July from 7.3% yoy in June, while PPI ex-food and energy inflation rose to 6.2% yoy from 5.6% yoy over the same period, both 0.6% above consensus.

The preliminary yoy rate of productivity growth declined to 2.3% in Q2 2021 from 4.3% yoy in Q1 2021 (revised from 5.4% yoy) while unit labour cost rose at 1.0% yoy from -2.8% yoy (revised from +1.7% yoy). Another indicator pointing towards lower economic activity and higher inflation was the University of Michigan Consumer Sentiment Index, which declined to 70.2 in the August preview from 81.2 in July and consensus. The current condition index declined 6.6 to 77.9 and expectations declined 13.8 to 65.2, both significantly below consensus. At the same time, 1-year inflation expectation declined only 0.1% to 4.6% while 5-10-year inflation expectations rose 0.2% to 3.0%.

United Kingdom: Real GDP growth rose 4.8% in Q2 2021 from -1.7% in Q1 2021 (revised from -2.0%), ahead of consensus.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.33%	-6.39%	0.61%	19.36%	9.86%	9.88%
MSCI EM Small Cap	-1.34%	-2.61%	16.75%	42.78%	12.61%	9.96%
MSCI Frontier	2.38%	2.12%	17.43%	36.79%	9.69%	9.64%
MSCI Asia	0.12%	-7.35%	-1.43%	16.86%	10.36%	11.14%
Shanghai Composite	3.55%	-1.18%	3.20%	8.12%	10.58%	5.22%
Hong Kong Hang Seng	1.63%	-11.37%	-10.77%	-5.92%	-1.17%	3.26%
MSCI EMEA	2.03%	2.15%	18.68%	32.75%	8.55%	6.03%
MSCI Latam	-0.52%	-4.55%	4.09%	28.93%	2.53%	3.15%
GBI-EM-GD	-0.73%	-1.16%	-4.49%	3.11%	5.05%	2.36%
China GBI-EM GD	-0.51%	1.16%	4.30%	11.34%	–	–
ELMI+	-0.37%	-0.87%	-1.47%	4.06%	2.64%	1.80%
EM FX spot	-0.46%	-1.62%	-3.16%	1.63%	-2.41%	-3.45%
EMBI GD	-0.06%	0.36%	-0.31%	2.69%	6.84%	4.24%
EMBI GD IG	0.11%	0.59%	-1.88%	-1.16%	7.84%	4.61%
EMBI GD HY	-0.23%	0.11%	1.53%	7.41%	5.62%	3.78%
CEMBI BD	0.23%	0.45%	1.73%	5.81%	7.76%	5.36%
CEMBI BD IG	0.03%	0.58%	0.44%	2.93%	6.98%	4.62%
CEMBI BD HY	0.47%	0.25%	3.46%	9.85%	8.73%	6.47%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.72%	4.13%	20.01%	34.46%	18.68%	17.57%
1-3yr UST	-0.08%	0.10%	0.01%	0.15%	2.69%	1.65%
3-5yr UST	-0.31%	0.41%	-0.64%	-0.44%	4.24%	2.18%
7-10yr UST	-0.37%	1.63%	-1.81%	-2.57%	6.37%	2.66%
10yr+ UST	-0.51%	3.12%	-5.05%	-7.81%	9.32%	3.55%
10yr+ Germany	0.58%	5.25%	-1.89%	1.29%	5.74%	2.31%
10yr+ Japan	-0.16%	0.87%	0.56%	0.78%	1.71%	0.18%
US HY	-0.35%	0.03%	3.65%	9.86%	6.97%	6.65%
European HY	0.34%	0.75%	4.25%	9.81%	4.23%	4.20%
Bloomberg-Barclays Agg	-0.31%	1.02%	-2.22%	1.11%	4.82%	2.33%
VIX Index*	-7.51%	6.57%	-25.85%	-23.49%	25.43%	33.47%
DXY Index*	0.45%	0.17%	2.95%	-0.54%	-4.19%	-2.32%
CRY Index*	-0.51%	1.68%	29.30%	45.41%	15.17%	16.25%
EURUSD	-0.76%	-0.58%	-3.64%	-0.74%	3.66%	4.53%
USDJPY	0.37%	1.62%	-5.51%	-3.05%	1.46%	-8.22%
Brent	-8.71%	-7.25%	34.52%	55.54%	-2.45%	41.54%
Gold	-2.18%	0.13%	-6.32%	-10.71%	50.67%	31.60%
Bitcoin	14.81%	38.94%	65.90%	299.61%	641.18%	8,112.64%

*VIX Index = Chicago Board Options Exchange SPX Volatility Index. *DXY Index = The Dollar Index. *CRY Index = Thomson Reuters / CoreCommodity CRM Commodity Index.

Source: Bloomberg, JP Morgan, Barclays, Merrill Lynch, Chicago Board Options Exchange, Thomson Reuters, MSCI, total returns.

Figures for more than one year are annualised other than in the case of currencies, commodities and the VIX, DX Y and CRY which are shown as percentage change.

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