4. **Low GEM valuations give some option value;** The relatively low level of valuations for some GEM markets and sectors, especially in terms of replacement cost (Figure 7 - EV/NCI is a reasonable proxy for replacement cost), mean that any positive turn in sentiment is likely to produce sharp rallies, albeit in an overall absolute and relative context that remains bearish.

Investors should take long-term structural positions and live with volatility, or else take shorter term disciplined contrarian approach

We prefer to base our recommendations on longer term strategic considerations rather than the more flow-based tactical calls, which are generally made on a *post hoc* basis to generate turnover. For those funds who feel the urge to pursue more active strategies however, we have continued to advocate a contrarian approach, which would have worked since early 2009 due largely to the increasing influence of momentum-based investors who focus on anticipated fund flows, which is an ultimately self-defeating strategy for most participants. The contrarian approach has continued to work well over 2013, both for GEM overall and for most individual markets, including all of the BRICs with the partial exception of Brazil. The pattern appears set to continue for the first part of 2014 but could shift if both China and the oil price finally break down, which should give dedicated investors the opportunity to generate some longer lasting alpha within the asset class.

Figure 8: Net foreign inflows (USD millions)

	India	Indonesia	Korea	Philippines	Taiwan	Thailand	ASEAN	Asia ex-Japan	Japan
Last 1 week	315	-26	80	-32	-611	-210	-268	-484	12,924
YTD	17,252	-1,397	6,047	808	7,068	-4,336	-4,925	25,442	124,175
2012	24,574	1,707	15,069	2,548	4,916	2,504	6,759	51,317	27,733
2011	-564	2,950	-8,584	1,329	-9,488	-167	4,112	-14,523	-323
2010	29,338	2,390	19,800	1,224	9,241	2,687	6,301	64,680	22,926
2009	17,644	1,383	24,659	420	14,752	1,136	2,938	5,993	-6,513
2008	12,900	1,732	-36,641	-1,135	-14,719	-4,788	-4,191	-68,451	-66,817
2007	18,558	3,598	-29,269	1,354	2,073	1,548	6,500	-2,138	32,759
2006	8,356	1,942	-12,659	720	17,424	2,067	4,730	17,852	68,885
2005	10,905	-1,735	-3,561	354	22,212	2,949	1,568	31,123	113,338
2004	8,642	2,126	10,134	278	9,865	103	2,507	30,647	95,603

(1) Correct as at 22 November 2013.
Source: Deutsche Bank, Bloomberg Finance LP

Country weightings unchanged – based on governance, oil and China view

We discuss the outlook for the individual markets at greater length, later in the report, but our country weightings for GEM remain unchanged and are still driven by the underweight positions which we have found much easier to determine, whilst we continue to find it very difficult to identify compelling overweights.

Underweight

- **China;** Whilst China appears cheap in aggregate, this is largely due to the dominant financials sector, where investors are discounting major book value impairments from NPLs; Materials stocks also generally have very low valuations whilst Healthcare and Consumer Staples stocks are among the more expensive in the asset class. MSCI China has outperformed our expectations over 2013 and sentiment appears somewhat elevated, which if the past four years is any guide, suggests