Issued: 1 July 2013

WEEKLY INVESTOR RESEARCH

Ashmore

Summary

Emerging Market assets rallied strongly over the past week as the markets stabilised on the back of softer US data, improving technicals and efforts by Emerging Market central banks and finance ministries to provide liquidity to the market. Emerging Markets were able to achieve this with very modest interventions, underlining the very large discrepancy between investor perceptions of Emerging Markets and the reality on the ground.

Emerging Markets	Index level/ yield	Spread over UST	1 week change
MSCI EM	941	–	6.59%
MSCI FM	528	–	-0.53%
GBI-GD	6.42%	–	2.50%
ELMI+	4.01%	–	0.87%
EMBI GD	5.80%	325 bps	2.82%
EMBI GD IG	4.83%	225 bps	2.53%
EMBI GD HY	9.21%	685 bps	3.32%
CEMBI BD	5.62%	350 bps	1.72%
CEMBI BD HG	4.76%	263 bps	1.58%
CEMBI BD HY	7.52%	545 bps	1.19%

Global backdrop	Index level/yield/ FX rate/price	1 week change
S&P 500	1,606	2.16%
VIX Index	16.86	-16.16%
5 year UST	1.43%	-2 bps
10 year UST	2.53%	-1 bps
10 year Bund	1.75%	-6 bps
EURUSD	1.3045	-0.57%
USDJPY	99.62	1.90%
Brent	$102	0.72%
Copper	$315	1.66%
Gold	$1242	-3.24%

Emerging Markets

As explained in last week's Weekly, there was a significant technical component to the sharp sell-off in Emerging Markets assets in June on account of positioning, leverage and a sharp reduction in market maker liquidity. Importantly, few if any fundamental developments in Emerging Markets lay behind the price action. This week we focus on the policy responses Emerging Markets put in place in the face of the violent price movements. The bottom-line is that Emerging Markets were able to provide liquidity to both FX and bond markets very successfully with very modest interventions. This underlines, once again, the resilience of Emerging Markets and the disconnect, which still exists between investors' perceptions about Emerging Markets (especially leveraged cross-asset investors) and the reality on the ground. This disconnect underlines once more that the Emerging Markets universe is the most inefficient market in the world: A strong credit focus and active management remains critical to investing in this asset class. We examined the policy responses to the recent sell-off in 38 of the most traded Emerging Markets countries.

1. Currency market interventions: Despite the violence of the currency moves in Emerging Markets there was no serious USD or EUR funding stresses, major capital flight, or other material problems. Officials were able to provide liquidity to FX markets with conventional measures. No countries resorted to international swap-lines, application for IMF programs, or other types of extraordinary external support. A total of 22 countries (58% of the countries) engaged in some kind of FX intervention, but interventions were all modest in size. While seven Emerging Markets countries sold USD or EUR,[1] four countries threatened to buy or actually bought dollars to prevent excessive appreciation.[2] Six regular 'interveners' did so within their established frameworks for FX intervention.[3] Romania engaged in moral suasion with local market participants to not sell local currency. Colombia and Peru reduced the pace of their regular dollar purchases, and Colombia renewed its Flexible Credit Line (not intended for use). The largest and broadest interventions – though still modest – took place in the countries with less conventional policies. Brazil, which was also experiencing domestic unrest unrelated to the US treasury market, sold $24bn, a larger absolute amount, but small in relation to total reserves ($375bn). Brazil also removed all IOF taxes on fixed income and derivatives and the reserve requirement for short-USD positions. India intervened to the tune of about $7bn, tightened norms for repatriation of export proceeds, put in place restrictions on gold purchases and imports, and relaxed rules on FDI inflows. Indonesia intervened by selling $4bn, hiked policy rates, and cutting subsidies domestic fuel prices. Turkey intervened about $1.3bn and reduced reserve requirements on dollar positions.
2. Bond Market interventions: 17 countries or 42% of the countries sampled engaged in some kind of action to stabilise bond markets. Four countries bought back bonds from the market,[4] while seven countries reduced auction volumes and/or cancelled planned supply.[5] India reduced quotas barring foreigners from entering the local market, while Colombian officials discussed reducing quotas for local institutions to invest abroad. Malaysia and Romania leaned on domestic institutions to buy. Uruguay raised reserve requirements

[1] Brazil, Hungary, Poland, Russia, South Korea, Turkey, and Ukraine.

[2] Czech Republic, Israel, Taiwan, and Uruguay.

[3] Indonesia, Malaysia, Nigeria, Philippines, Singapore, and Thailand.

[4] Colombia, Brazil, South Korea, Thailand.

[5] Colombia, Hungary, Mexico, South Korea, Poland, Romania, and Russia.

Continued overleaf

Ashmore

Emerging Markets

on foreign holders of inflation linked bonds. Turkey moved funding of bond positions to o/n from weekly funding. Brazil and Indonesia raised interest rates. Vietnam and Hungary cut rates. In addition, Romania completed its IMF program negotiations. African countries mostly cut rates, though Ghana and Zambia raised rates.

The Emerging Markets fundamental outlook is broadly unchanged. We expect growth to be marginally stronger than last year, picking up in H2 2013 after this half's manufacturing slowdown. We expect the strongest pickups in larger countries, such as Brazil, India, and China. Short term external debt coverage in Asia, a problem in the late 1990s, is now very strong with reserve levels twice as high as short term debt across all major Asian countries. External debt to reserves across Emerging Markets is ultra-low at just 1.9 times compared to 38.5 times in the HIDCs (Heavily Indebted Developed Countries). External debt to GDP ratios (including intercompany loans) also strongly favour Emerging Markets at just 19% of GDP compared to 271% of GDP in the HIDCs.

Global backdrop

The US treasury market bounced back strongly over the past week as weaker US data and increasingly dovish commentary from US Federal Reserve officials suggested that the bond market's reaction to the announcement of tapering of Quantitative Easing (QE) was overdone. At one point, more than 100bps of hikes was priced in by June 2015. But then US Q1 GDP growth was revised down to 1.8% (from an original print of 3.5%) and the consumer data for the month of May suggested that growth in Q2 2013 may be even slower (around 1.4%). There was also evidence that the rising mortgage rates in the US was causing the pace of mortgage applications to slow sharply, though higher frequency manufacturing and housing were slightly stronger than expected. Still, with core PCE inflation in May running at 1.05% it begs the question what motivated the Fed to announce the unwinding of QE at this precise time. A raft of Fed officials across the spectrum from hawk to dove tried to answer this question and by the end of the week the US treasury market had begun to rally. There was also good news in Europe, where European finance ministers agreed on a framework for dealing with future banking crises (though without solving the existing one). In Emerging Markets, the two headline grabbing events from last week receded somewhat from view as China's central banks stabilised the interbank market with verbal and targeted cash, and the Brazilian parliament has scrapped proposals to restrict prosecutors from investigating official corruption following protests against state inefficiency.

Contact

Head Office

Ashmore Investment Management Limited
61 Aldwych, London
WC2B 4AE
T: +44 (0)20 3077 6000
@AshmoreEM
www.ashmoregroup.com

Other Locations

Beijing
T: +86 10 5764 2601

Bogota
T: +57 1 347 0649

Jakarta
T: +6221 2953 9000

Istanbul
T: +90 212 349 40 00

Melbourne
T: +61 0 3 9653 9524

Moscow
T: +74 9566 04258

Mumbai
T: +91 22 6608 0000

New York
T: +1 212 661 0061

Sao Paulo
T: +55 11 3556 8900

Shanghai
T: +86 21 3855 6766

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

Washington
T: +1 703 243 8800

Bloomberg Page
Ashmore <GO>

Fund Prices
www.ashmoregroup.com
Bloomberg
FT.com
Reuters
S&P
Lipper