**Issued:** 11 December 2017

WEEKLY INVESTOR RESEARCH

Ashmore

# A few big elections in EM next year

By Jan Dehn

Get ready to make some alpha! 2018 is an important election year for a small number of prominent Emerging Markets (EM) countries, including Brazil, Mexico and Russia. Markets tend to dramatically exaggerate the implications of different election outcomes, wherefore elections typically present very lucrative alpha generation opportunities for active managers. The Weekly also discusses the Brazilian central bank's latest rate cut, China's slowing inflation rate, Argentina's reform package, Chile's bumper trade surplus, Sinopec's tiff with PDVSA, the demise of Yemen's Saleh and local currency settlement in Indonesia, Malaysia and Thailand.

| Emerging Markets | Next year forward PE/Yield | Spread over UST | P&L (5 business days) |
|---|---|---|---|
| MSCI EM | 12.1 | – | -0.45% |
| MSCI EM Small Cap | 12.8 | – | -2.14% |
| MSCI Frontier | 12.2 | – | 0.79% |
| MSCI Asia | 12.7 | – | -0.41% |
| Shanghai Composite | 13.0 | – | -0.83% |
| Hong Kong Hang Seng | 7.8 | – | -1.40% |
| MSCI EMEA | 10.3 | – | -1.10% |
| MSCI Latam | 13.3 | – | -0.99% |
| GBI-EM-GD | 6.15% | – | -0.15% |
| ELMI+ | 3.40% | – | -0.32% |
| EM FX spot | – | – | -0.39% |
| EMBI GD | 5.29% | 290 bps | 0.06% |
| EMBI GD IG | 4.04% | 163 bps | -0.05% |
| EMBI GD HY | 6.63% | 427 bps | 0.17% |
| CEMBI BD | 5.06% | 274 bps | 0.03% |
| CEMBI BD IG | 4.15% | 184 bps | 0.01% |
| CEMBI BD Non-IG | 6.28% | 395 bps | 0.06% |

| Global Backdrop | Next year forward PE/Yield/Price | Spread over UST | P&L (5 business days) |
|---|---|---|---|
| S&P 500 | 18.0 | – | 0.39% |
| 1-3yr UST | 1.80% | – | -0.01% |
| 3-5yr UST | 2.14% | – | -0.06% |
| 7-10yr UST | 2.38% | – | -0.12% |
| 10yr+ UST | 2.77% | – | -0.25% |
| 10yr+ Germany | 0.30% | – | -0.04% |
| 10yr+ Japan | 0.05% | – | 0.05% |
| US HY | 5.70% | 347 bps | 0.05% |
| European HY | 2.91% | 358 bps | -0.23% |
| Barclays Ag | – | 253 bps | 0.02% |
| VIX Index* | 9.58 | – | -1.85% |
| DXY Index* | 93.77 | – | 0.59% |
| EURUSD | 1.1788 | – | -0.66% |
| USDJPY | 113.43 | – | 0.91% |
| CRY Index* | 185.02 | – | -5.67% |
| Brent | 63.4 | – | 1.44% |
| Gold spot | 1250 | – | -2.05% |

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

## Emerging Markets

- **Elections in 2018:** Active EM asset managers should rejoice at the prospect of a number of important elections across the world in 2018. The run-up to elections is almost always characterised by serious mispricing of assets as the implications of different election outcomes are taken to unreasonable extremes. This creates major alpha generation opportunities in most cases. There is little doubt that the two most important EM elections next year will be Mexico's general election in July and Brazil's general election in October. Russia's President Vladimir Putin announced last week that he will seek re-election for another 6-year term in March 2018; unlike the elections in Mexico and Brazil we think the Russian election will not spark much trading activity due to Putin's solid approval ratings. There will also be close attention paid to Venezuela's presidential election (the date has still to be determined) and Colombia's parliamentary and presidential elections in March and May, respectively. Paraguay also has elections in 2018. In Asia, the three most important elections are the parliamentary elections in Malaysia and the general elections in Pakistan and Thailand. In Emerging Europe the main focus will be the parliamentary election in Hungary.

In the developed economies the main focus will undoubtedly be the US mid-term elections, which may well render President Trump a lame duck for the rest of his term, much like what happened to President Barack Obama after the mid-term election in his first term. In Western Europe the Irish and Italian elections will be a source of volatility as might the UK local elections, given the fragility of the current UK government. Over the coming months more and more press attention and market speculation will concentrate on these events as election dates are firmed up, candidates chosen and policy proposals are put forward.

Thus, last week Ricardo Anaya resigned from his post as president of the National Action Party (PAN) in Mexico in order to seek his party's nomination to run for president in 2018. In Brazil, Sao Paulo Governor Geraldo Alckmin was elected leader of the Brazilian Social Democracy Party (PSDB), which means that he will most likely be his party's candidate in the general election. Sebastian Pinera and Alejandro Guillier face off in the second round of the presidential election in Chile, which takes place later this month. Also this month,

*Continued overleaf*

## Emerging Markets

South Africa's ruling ANC party will select a new party president in a decision which may have far-reaching consequences for the outlook of South African politics and economy. Other countries with general, local, presidential or parliamentary elections in 2018 include Zimbabwe, Gabon, Egypt, Indonesia, South Korea and Lebanon.

- Brazil: The monetary policy committee of the Brazilian central bank (COPOM) cut the policy rate by 50bps to 7% and issued a statement, which suggests at least another 25bps of additional rate cuts in the coming quarters. The rate cut seems justified by the great degree of slack in the economy, which pushed IPCA inflation to a lower than expected 0.28% in November, down from 0.42% mom in October. Inflation is well within the lower band of the central bank's target range. The economy also strengthened as industrial production expanded at a rate of 5.3% yoy in October.

- China: The yoy rate of CPI inflation declined to 1.7% in November compared to market expectations of 1.8% yoy and 1.9% in October. Producer price inflation slowed to a rate of 5.8% yoy in November from 6.9% yoy in October. The slowdown in inflation took place against a backdrop of stronger data as the Caixin services PMI number rose to 51.9 in November from 51.2 in October and the trade surplus increased to a much stronger than expected USD 40.2bn (the consensus expectation was USD 35.0bn). The bigger than anticipated trade surplus was due to very strong exports (12.3% yoy in November versus 5.3% yoy expected). Imports also beat expectations (17.7% yoy in November versus 13.0% yoy expected).

- Argentina: President Mauricio Macri has submitted a package of bills to parliament for approval before year-end. The package includes the 2018 Budget, a fiscal pact with provincial governments and a tax reform. Passage is expected by the end of the December. In other news, former President Cristina Kirchner has been indicted on charges of treason for allegedly covering up Iran's alleged role in a 1994 bombing of a Jewish community centre in Buenos Aires. However, Kirchner has parliamentary immunity by virtue of her status as Senator.

- Chile: Chile's cumulative 12-month rolling trade surplus reached USD 6.8 bn in November on the back of a USD 512m surplus in the month. This compares to a 12-month cumulative surplus of USD 5.3bn at the same time in 2016 and is the highest trade surplus in Chile since April 2015. Inflation was 1.9% yoy in November, below central bank's target range for the sixth consecutive month.

- Venezuela: The US affiliate of Sinopec, the Chinese oil company, has sued PDVSA, the national oil company of Venezuela, for USD 23.7m due in unpaid bills. We do not think this action reflects a significant change in Chinese-Venezuelan relations. Instead, we think US Sinopec is merely conducting business along American lines and that Chinese Sinopec will continue to conduct business along Chinese lines. In local elections at the weekend, PSUV, the ruling party, won more than 90% of the 335 seats, according to the National Electoral Council. The opposition abstained.

- Yemen: President Ali Abdullah Saleh was killed last week. His death will create a power vacuum out of which may or may not emerge a different balance of power between the warring parties. In other words, the uncertainty surrounding the situation in Yemen is now greater. Still, we do not think that Saleh's demise will alter the underlying forces fuelling this conflict, namely the rivalry for regional influence between Iran and Saudi Arabia.

- Local currency settlement: The three central banks of Indonesia, Malaysia and Thailand have launched a new system to facilitate direct settlement of local currency denominated bond transactions in their local currencies instead of having to settle via the US Dollar. This makes infinite sense to us. While foreign investors in EM local markets often take exposure from funds, which account in Dollars, local investors within EM typically have accounts, which are in their own currencies, so for them it is both expensive and unnecessary to have to trade with each other via the Dollar.

Snippets:

- Colombia: CPI inflation was modestly higher than expected in November (0.18% mom versus 0.11% mom expected) due to higher non-tradable prices. Yoy inflation now runs at 4.12% compared to 4.05% in October.
- Egypt: Inflation fell sharply in November albeit from a high level. The yoy rate of inflation dropped to 26% in November from 30.8% in October.
- India: The Reserve Bank of India kept the main policy rate unchanged at 6% as services PMI declined to 48.5 in November from 51.7 in October.
- Malaysia: The country's trade surplus in October increased to USD 2.5bn from USD 2.0bn in September.
- Nigeria: The central bank's FX reserves increased to USD 38.2bn from a low of USD 24bn last year.
- Peru: The 12-month rolling trade surplus in October was 2.8% of GDP, unchanged from September.

*Continued overleaf*

## Emerging Markets

- **Philippines:** Fitch raised the sovereign credit rating of the Philippines one notch further into investment grade to BBB from BBB- following a recent tax reform. The rate of consumer prices inflation was 3.3% yoy in November, which was lower than in October (3.5% yoy).
- **Poland:** The central bank's monetary policy committee left the policy rate unchanged at 1.5%.
- **Romania:** The government's draft budget proposal was approved by Cabinet. The budget has a deficit just below the EU's 3% of GDP limit and assumes real GDP growth of 5.5% for next year.
- **South Africa:** Real GDP in Q3 2017 was 2.0% qoq ar versus 1.7% qoq ar expected.
- **South Korea:** The National Assembly passed the 2018 Budget and an accompanying tax reform, which will raise corporate taxes and taxes on high income earners.
- **Russia:** The rate of CPI inflation dropped to a fresh all-time low of 2.5% yoy in November.
- **Taiwan:** The rate of core CPI inflation increased to a still modest 1.3% yoy in November from 1.1% in October. Exports rose at a rate of 14% yoy in November versus 9.4% yoy expected.
- **Turkey:** Turkey's economy expanded at a monster rate of 11.1% yoy in Q3 2017 versus 8.5% yoy expected and 5.4% yoy in Q2 2017. This high rate is mainly a reflection of the very low base due to the attempted coup in Q3 2016.

## Global backdrop

United States non-farm payrolls increased by 228K in November and the rate of unemployment was unchanged at 4.1%. Despite the strong employment data hourly earnings were weaker than anticipated and earlier in the week unit labour costs had also disappointed (-0.2% qoq saar versus +0.5% qoq saar expected for Q3 2017). ISM services and the trade numbers were also weaker than expected. The weak higher frequency data extends a trend, which saw manufacturing data softer than expected the previous week. It is worth watching this growing dissonance between high frequency activity indicators and the strong labour market numbers, because labour market indicators often lag other indicators at turning points in the cycle. Still, we expect the FOMC to hike the fed funds rate by 25bps this week. The Fed is keen to use every opportunity presented by bouts of stronger data or buoyancy in the stock market to get a hike on its books, just in case a recession strikes. As far as US fiscal policy is concerned, the two versions of the Trump tax cut bills from the House and the Senate have still not be reconciled, but this seems likely to happen within the next few weeks. S&P Global Ratings Chief Moritz Kraemer warned that the tax cut could lead to negative rating action unless countervailing measures are found to address the longer-term negative fiscal implications.

In the UK, the tail risk of an immediate breakdown in Brexit talks between the UK and the EU was averted as the two sides struck a deal. The deal appears to strongly favour the EU, which is hardly surprising, but it now remains to be seen if Prime Minister Theresa May can hold together her fragile and deeply divided coalition.

In Europe, the German Social Democratic Party (SPD) voted with large majority to hold talks with Chancellor Angela Merkel about a grand coalition. The leader of the SPD echoed French President Emmanuel Macron when he put forward ambitious proposals to further the goal of a federal United States of Europe. German conservatives will have reservations about moving in this direction, not because they oppose a Federal Europe, but because they want more reforms and better fiscal policies before moving towards greater European fiscal integration. Still, the fact that European politicians are slowly regaining the vision and courage to propose concrete action to further integration is a clear sign that Europe is on the up again. In other news, European real GDP growth was 2.4% qoq saar in Q3 2017 and manufacturing PMIs were strong across the continent.

*Continued overleaf*

Ashmore

## Emerging Markets

| Emerging Markets | Month to date | Year to date | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| MSCI EM | -0.88% | 31.71% | 29.61% | 7.19% | 4.42% |
| MSCI EM Small Cap | -2.45% | 26.08% | 24.85% | 6.11% | 5.04% |
| MSCI Frontier | 1.24% | 29.41% | 31.29% | 3.65% | 9.19% |
| MSCI Asia | -0.72% | 37.26% | 32.75% | 9.43% | 7.95% |
| Shanghai Composite | -0.82% | 8.19% | 4.43% | 4.85% | 12.44% |
| Hong Kong Hang Seng | -1.62% | 24.98% | 18.64% | 2.07% | 4.67% |
| MSCI EMEA | -2.25% | 14.39% | 17.31% | 1.92% | -1.09% |
| MSCI Latam | -0.60% | 18.07% | 19.47% | 1.58% | -3.14% |
| GBI EM GD | -0.32% | 12.57% | 12.98% | 0.94% | -1.73% |
| ELMI+ | -0.44% | 10.05% | 9.63% | 1.41% | -0.71% |
| EM FX Spot | -0.67% | 4.16% | 4.32% | -5.52% | -7.11% |
| EMBI GD | 0.19% | 9.66% | 10.31% | 6.53% | 4.56% |
| EMBI GD IG | 0.15% | 8.97% | 9.00% | 4.81% | 3.21% |
| EMBI GD HY | 0.23% | 10.43% | 11.76% | 8.37% | 6.25% |
| CEMBI BD | 0.10% | 7.73% | 8.13% | 5.92% | 4.68% |
| CEMBI BD IG | 0.08% | 6.15% | 6.36% | 4.30% | 3.83% |
| CEMBI BD Non-IG | 0.13% | 10.07% | 10.80% | 8.42% | 6.00% |

| Global Backdrop | Month to date | Year to date | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| S&P 500 | 0.19% | 20.72% | 20.45% | 11.07% | 15.71% |
| 1-3yr UST | 0.02% | 0.42% | 0.42% | 0.62% | 0.57% |
| 3-5yr UST | 0.03% | 1.05% | 0.95% | 1.35% | 0.99% |
| 7-10yr UST | 0.28% | 2.66% | 2.62% | 1.95% | 1.33% |
| 10yr+ UST | 1.06% | 7.93% | 8.58% | 3.49% | 2.97% |
| 10yr+ Germany | 0.95% | -0.81% | 2.04% | 3.95% | 5.53% |
| 10yr+ Japan | 0.08% | 0.21% | -0.25% | 4.49% | 4.91% |
| US HY | 0.05% | 7.24% | 8.01% | 6.18% | 5.86% |
| European HY | -0.20% | 5.79% | 6.96% | 5.35% | 7.22% |
| Barclays Ag | 0.37% | 5.44% | 6.17% | 3.93% | 3.79% |
| VIX Index* | -15.07% | -31.77% | -18.47% | -52.29% | -38.47% |
| DXY Index* | 0.78% | -8.25% | -7.69% | 5.76% | 17.13% |
| CRY Index* | -2.20% | -3.89% | -3.63% | -24.61% | -37.04% |
| EURUSD | -0.97% | 12.05% | 10.85% | -5.02% | -9.36% |
| USDJPY | 0.79% | -3.05% | -1.38% | -4.40% | 37.46% |
| Brent | -0.35% | 11.49% | 16.60% | -0.52% | -41.35% |
| Gold spot | -1.96% | 8.47% | 7.54% | 1.82% | -26.92% |

*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, DXY and CRY which are shown as percentage change.

*Continued overleaf*

Ashmore

## Contact


**Head office**

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

**Bogota**
T: +57 1 316 2070

**Dubai**
T: +971 440 195 86

**Jakarta**
T: +6221 2953 9000

**Mumbai**
T: +91 22 6608 0000

**New York**
T: +1 212 661 0061

**Riyadh**
T: +966 11 483 9100

**Singapore**
T: +65 6580 8288

**Tokyo**
T: +81 03 6860 3777

**Other locations**
**Lima**
**Shanghai**


**Bloomberg page**
Ashmore <GO>

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