A disturbance in the force

By Jan Dehn

The common denominator linking the US Trade War with China, sanctions against Russia and the attacks on Syria was that there were no attempts made to find solutions to these conflicts within multilateral institutions, such as the UN and the World Trade Organisation (WTO). The word used to describe the act of seeking justice outside the formal framework of the law is vigilantism. Vigilantism leads to abuses of power, miscarriages of justice and insecurity. The descent into vigilantism will make the world a less safe place.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.2	–	0.74%
MSCI EM Small Cap	11.5	–	0.92%
MSCI Frontier	10.9	–	-0.63%
MSCI Asia	11.7	–	1.72%
Shanghai Composite	10.6	–	0.89%
Hong Kong Hang Seng	7.1	–	2.45%
MSCI EMEA	9.5	–	-2.69%
MSCI Latam	12.5	–	-0.03%
GBI-EM-GD	6.05%	–	-0.07%
ELMI+	3.82%	–	-0.16%
EM FX spot	–	–	-0.04%
EMBI GD	5.78%	295 bps	-0.26%
EMBI GD IG	4.56%	172 bps	-0.23%
EMBI GD HY	7.15%	433 bps	-0.29%
CEMBI BD	5.52%	273 bps	-0.10%
CEMBI BD IG	4.59%	180 bps	-0.08%
CEMBI BD Non-IG	6.66%	387 bps	-0.12%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.4	–	2.04%
1-3yr UST	2.38%	–	-0.12%
3-5yr UST	2.69%	–	-0.30%
7-10yr UST	2.84%	–	-0.38%
10yr+ UST	3.04%	–	-0.29%
10yr+ Germany	0.52%	–	-0.28%
10yr+ Japan	0.04%	–	0.41%
US HY	6.06%	326 bps	0.79%
European HY	2.87%	369 bps	0.65%
Barclays Ag	–	250 bps	-0.01%
VIX Index*	17.41	–	-4.08%
DXY Index*	89.73	–	-0.11%
EURUSD	1.2335	–	0.11%
USDJPY	107.29	–	0.49%
CRY Index*	199.70	–	7.45%
Brent	71.9	–	4.71%
Gold spot	1343	–	0.52%

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

Emerging Markets

- **China:** President Xi Jinping announced a number of new measures to open up China's markets to foreign trade and finance, including insurance. These steps are consistent with the government's stated reform objectives. Indeed, they were prefaced by recent regulatory changes, such as the decision to place insurance and banking regulation under the control of the PBOC a few weeks ago. As such, they are not to be viewed as a response to US President Trump's threat of further tariffs on China. Rather, China's reform program is the vehicle for re-orienting the Chinese economy towards domestic demand-led growth. This requires the liberalisation of China's current and capital accounts, which began soon after the Developed Markets Crisis of 2008/09. We do not expect China to use its currency or its large holdings of US Treasury bonds to retaliate against Trump's aggressive protectionist threats. While China will respond to US tariffs with tariffs of its own – and we may get news about Trump's next batch of tariffs this week – we expect China only to match, not to exceed the US measures.

The reason for China's moderation is that China is playing a far longer game. China's focus is to establish its reputation for financial prudence and mature policy-making as the country prepares to replace the US as the global financial and economic hegemon over the next two to three decades. This is obviously a very good time to do so as the US drifts towards fiscal unsustainability and protectionism. We also expect China to continue to work within the international framework for resolving conflicts. China's decision to file a case against US steel and aluminium tariffs at the WTO only last week is a case in point.

In other news, Chinese inflation slowed to a rate of 2.1% yoy in March from 2.9% yoy in February, supporting bonds given a consensus expectation of 2.6% yoy. The rate of Chinese export growth declined from an outsized 44% yoy in February to a lower than expected -2.7% yoy in March. This volatility in exports, which reflects production, was due to the effect of Chinese New Year celebrations. This is consistent with the solid performance for imports (up 14.4% yoy), which reflects consumption. Credit data was similarly impacted by the New Year celebrations and should be discounted accordingly.

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Emerging Markets

- Russia: The Syrian situation is a classic proxy conflict pitting Western nations against Russia. The decision to bomb Syrian chemical weapons facilities marks a clear escalation in tensions with Russia, which may be ramped up further this week if the US imposes additional sanctions on Russia over its support for Syrian President Bashar Hafez al-Assad. Russian markets weakened last week in response to an earlier round of sanctions on Russian companies, including Rusal, a major aluminium producer. The market reaction notwithstanding Russia is in a far stronger position today to cope with a hostile external environment than in 2014, when Russia faced a triple whammy of falling oil prices, international vilification over the invasion of Crimea and sanctions on Russian quasi-sovereign companies. Back then, investors also panicked, but markets normalised less than a year later and investors, who bought Russian assets during the height of the panic, were rewarded handsomely. Today, Russia's foreign exchange reserves cover some 85% of all foreign debt in Russia, including all private sector foreign obligations as well as all foreign holdings of OFZs (Russian local currency denominated sovereign bonds). Russia's exchange rate and domestic demand have also adjusted to lower oil prices.

- Colombia: Ivan Duque has a lead of 35% of voting intentions ahead of Colombia's upcoming presidential election. Duque is widely regarded as a market friendly candidate. The markets fear Gustavo Petro more, but he lags behind with 25% of voting intentions, according to Cifras y Conceptos, a local pollster.

- Mexico: Moody's lifted the outlook for Mexican sovereign debt to stable from negative on improving prospects for a benign outcome of NAFTA negotiations. Industrial production rose 0.4% mom in February, in line with expectations and the Central Bank left the policy rate unchanged at 7.5% in line with expectations.

- Brazil: A new poll shows environmentalist Marina Silva and far right populist Jair Bolsonaro leading mainstream candidates in the first round ahead of the general election scheduled for Q3 2018. Second round simulations point to a Marina Silva victory, but this was also the case in a prior election, which saw Silva fade later in the contest. This election is likely to be less favourable to mainstream candidates due to changes in election funding rules. In other news, retail sales expanded at a yoy rate of 5.2% in February, which is marginally slower than expected (6.1% yoy). The rate of inflation slowed further to 2.68% yoy in March from 2.86% yoy in February.

Snippets:

- Argentina: Inflation remains stubbornly high with a monthly increment in the CPI of 2.3% in March, which translates into 25.4% yoy, unchanged from February. The Central Bank left the policy rate unchanged at 27.25%.
- Ghana: Real GDP growth was 8.5% in 2017, up from 3.7% in 2016.
- India: CPI inflation slowed to 4.3% yoy in March from 4.4% yoy in February, while industrial production expanded at a solid 7.1% yoy rate. The trade deficit widened to USD 13.7bn in March from USD 12bn in February).
- Indonesia: Export growth beat expectations in March to help push the trade balance into a USD 1.1bn surplus.
- Malaysia: February industrial production was broadly in line with expectations (3.0% yoy versus 3.3% yoy anticipated). The next General Election data has been set for 9th May 2018.
- Peru: The Central Bank left the policy rate unchanged at 2.75% in line with expectations.
- Philippines: The trade deficit narrowed to USD 3.1bn in February from USD 3.3bn in January.
- Poland: The Central Bank left the policy rate unchanged at 1.5%. S&P revised Poland's sovereign credit outlook to positive from stable.
- Romania: Inflation ticked higher in March, hitting a 4.95% yoy rate from 4.73% yoy in February.
- Serbia: National Bank of Serbia cut the policy rate by 25bps to 3.0%.
- Singapore: The Monetary Authority of Singapore increased the pace of appreciation of the nominal effective exchange rate, a tightening measure.
- South Korea: The Bank of Korea left the policy rate unchanged at 1.5% in line with expectations. A rising participation rate pushed the unemployment rate up to 4.0% in March from 3.6% in February.
- Taiwan: The rate of inflation declined to 1.6% yoy in March from 2.2% yoy in February.
- Turkey: President Erdogan's new program of incentives to increase investment are not consistent with macroeconomic stability, in our view.
- Venezuela: Henri Falcon leads in polls of voter intentions ahead of the presidential election scheduled for 20 May 2018.

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Global backdrop

Conflicts between nation states are so common that they make up a constant element in the global backdrop. Seen in this light, the present conflicts pitting Western nations against Syria, the US against Russia and Trump against Xi Jinping over trade are merely the latest in an endless string of geopolitical flashpoints most of which flare up and subside leaving no permanent disturbance in the force.

Yet, these latest three disputes do stand out from their predecessors in one important respect, namely that there were no attempts whatsoever made to resolve them within the institutions specifically designed for this purpose, such as the UN or the WTO. These conflicts stand apart from their predecessors in that the world's most powerful nations are 'going it alone', that is, either acting entirely on their own or in very narrow coalitions.

The temptation to act alone or in small groups is understandable. Multilateral institutions are often lacking when it comes to decisive international action against nations, which break international law. The impotence of international institutions can be particularly galling, when countries, such as Syria, ride rough shot over basic human rights and international law, seemingly without repercussions.

Yet, when the world most powerful nations take the law into their own hands, the dangers are even greater than the trespasses of rogue states. When erstwhile law-abiding nations place themselves above international law, even when the cause appears just, they are in fact lowering themselves to the same lawless standards as the rogues they seek to punish.

The word used to describe the act of taking unilateral action outside the framework of the law is vigilantism. No nation state will stand idly by if its citizens take the law into their own hands, regardless of the state of its domestic politics. This is because vigilantism leads to abuse of power, miscarriages of justice and insecurity. The same is true on the international stage. The global interest is best served by adhering to clear rules enforced by effective international institutions and if the rules and/or the institutions do not work as intended then true leadership is to try to reform them to ensure that they become more effective.

Vigilantism is the opposite of global leadership. Indeed, the countries perpetrating global crime, such as Syria, and the countries joining the lynching party in pursuit of revenge, such as the US, UK and France, are undermining international law. They are directly undermining the very institutions required to move the world towards order and stability. They are serving narrow political self-interest, not the global interest.

The outbreak of vigilantism is a direct result of rising inequality, growing marginalisation of large sections of society and generalised stagnation following the Developed Markets Crisis of 2008/2009. There is a craving among many in the Western world for strong and decisive leadership. Unfortunately, leaders often find it easier to display their strength and decisiveness by targeting obvious objects of hatred, such as Syria's Assad or Russia's Putin or distant inscrutable China than to tackle the complex underlying problems, which give rise to populism in the first place. As such, there is every reason to believe that things will get worse rather than better. Domestic discontentment easily morphs into cross-border scapegoating and eventually into direct conflict following large economic crises. We have now reached the point where the most powerful nations in the world blatantly disregard global governance rules and institutions. Investors should beware. The world just became a less safe place.

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Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	0.00%	1.38%	24.63%	6.83%	5.66%
MSCI EM Small Cap	1.41%	1.58%	20.07%	5.34%	5.24%
MSCI Frontier	-0.98%	4.11%	24.80%	6.76%	8.04%
MSCI Asia	0.85%	1.45%	26.46%	7.22%	9.05%
Shanghai Composite	-0.30%	-4.46%	-1.59%	-6.73%	10.03%
Hong Kong Hang Seng	2.19%	4.71%	24.97%	-2.05%	6.93%
MSCI EMEA	-2.80%	-3.62%	15.48%	2.77%	0.17%
MSCI Latam	-0.15%	7.95%	19.67%	8.28%	-1.67%
GBI EM GD	-0.66%	3.75%	11.60%	4.75%	-1.35%
ELMI+	-0.45%	2.06%	7.99%	3.31%	-0.40%
EM FX Spot	-0.66%	1.41%	3.69%	-1.95%	-6.77%
EMBI GD	0.15%	-1.60%	3.61%	5.23%	4.17%
EMBI GD IG	0.08%	-2.34%	2.24%	2.89%	2.74%
EMBI GD HY	0.21%	-0.91%	4.95%	7.99%	5.83%
CEMBI BD	0.11%	-1.02%	3.16%	4.62%	4.00%
CEMBI BD IG	-0.04%	-1.38%	1.72%	2.93%	3.22%
CEMBI BD Non-IG	0.30%	-0.54%	5.17%	7.22%	5.03%

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	0.66%	-0.10%	16.31%	10.54%	13.13%
1-3yr UST	-0.10%	-0.25%	-0.27%	0.33%	0.48%
3-5yr UST	-0.33%	-1.07%	-1.26%	0.40%	0.69%
7-10yr UST	-0.55%	-2.40%	-2.21%	0.01%	0.77%
10yr+ UST	-1.00%	-4.26%	0.05%	0.19%	2.41%
10yr+ Germany	-0.31%	0.79%	-2.74%	-1.08%	4.93%
10yr+ Japan	0.43%	1.44%	2.15%	4.43%	4.42%
US HY	1.09%	0.22%	4.53%	5.21%	5.06%
European HY	0.78%	0.23%	4.58%	4.30%	6.32%
Barclays Ag	0.00%	-1.41%	2.01%	2.56%	3.23%
VIX Index*	-12.82%	57.70%	9.09%	38.17%	24.71%
DXY Index*	-0.46%	-2.60%	-10.70%	-7.89%	9.77%
CRY Index*	2.22%	3.01%	6.35%	-11.53%	-29.49%
EURUSD	0.09%	2.75%	15.89%	14.62%	-6.39%
USDJPY	0.95%	-4.79%	-1.49%	-9.85%	10.00%
Brent	2.29%	7.49%	28.61%	12.35%	-28.06%
Gold spot	1.38%	3.09%	4.57%	12.08%	-1.79%

*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.

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