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WEEKLY INVESTOR RESEARCH

Ashmore

Change of the guard in Malaysia

By Jan Dehn

In a continuation of trends observed in many other Emerging Markets countries, Malaysian voters last week ousted a Prime Minister widely perceived to have been corrupt. Argentina's government responded to the currency crisis in the best possible way by raising rates, introducing fiscal measures, passing a capital markets reform and approaching the IMF. In Brazil, Barbosa's withdrawal from the election race increases the odds of a market friendly election outcome. Ecuador's President Lenin Moreno shakes up his Cabinet to replenish his capital as he enters the second year of his term in office. Mexican inflation declined meaningfully and the central bank hiked the policy rate in the Philippines. The global backdrop improved from an EM perspective as EURUSD stabilises despite the US withdrawal from the Iran nuclear treaty.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.2	–	2.52%
MSCI EM Small Cap	11.4	–	0.69%
MSCI Frontier	10.6	–	-1.14%
MSCI Asia	11.8	–	2.61%
Shanghai Composite	11.0	–	2.36%
Hong Kong Hang Seng	7.5	–	3.84%
MSCI EMEA	9.8	–	3.41%
MSCI Latam	12.2	–	0.71%
GBI-EM-GD	6.28%	–	-0.29%
ELMI+	4.41%	–	0.06%
EM FX spot	–	–	0.03%
EMBI GD	6.20%	322 bps	0.34%
EMBI GD IG	4.79%	181 bps	0.60%
EMBI GD HY	7.79%	482 bps	0.08%
CEMBI BD	5.85%	291 bps	-0.10%
CEMBI BD IG	4.85%	191 bps	-0.10%
CEMBI BD Non-IG	7.08%	413 bps	-0.10%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.7	–	2.49%
1-3yr UST	2.54%	–	-0.03%
3-5yr UST	2.85%	–	-0.16%
7-10yr UST	2.98%	–	-0.25%
10yr+ UST	3.12%	–	0.00%
10yr+ Germany	0.60%	–	-0.32%
10yr+ Japan	0.05%	–	-0.10%
US HY	6.27%	333 bps	0.28%
European HY	2.84%	372 bps	0.10%
Barclays Ag	1.99%	-99 bps	-0.03%
VIX Index*	13.09	–	-1.66%
DXY Index*	92.36	–	-0.39%
EURUSD	1.1983	–	0.51%
USDJPY	109.51	–	0.39%
CRY Index*	203.56	–	0.30%
Brent	77.1	–	1.23%
Gold spot	1320	–	0.42%

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

Emerging Markets

- **Malaysia:** Change of the guard. In line with a broadening trend seen in many other Emerging Markets (EM) countries, Malaysians went to the polls last week to oust a leader, who was widely perceived to be corrupt. Prime Minister Najib Razak of the Barisan Nasional (BN) alliance was unseated in a surprise election outcome, which favoured Mahathir bin Mohamad, a veteran politician of the Pakatan Harapan alliance. Najib and his wife stand accused by US investigators of money laundering involving the 1MDB state fund. In his previous tenure as Prime Minister (1981-2003), 92-year old Mahathir oversaw the rapid modernization of the economy and major infrastructure investment. He also limited the independence of the Judiciary and the traditional power of Malaysia's royal family. This is the first time in sixty years that the BN alliance is no longer in power, so one should expect Malaysia's government to enter a period of significant change, which may temporarily slow down investment. On the other hand, Mahathir's rise to power offers a chance to revamp the failing institutions in the country and to address some public grievances, including security, racial divisions and above all corruption. Mahathir has promised to remove GST and re-introduce fuel subsidies, which would be negative developments, but Malaysia's macro economy is healthy enough to absorb these changes without meaningful impact on overall stability. In other news, industrial production declined 0.3% in March, which reduced the yoy rate of increase to 3.1% versus a consensus expectation of 3.5%. Bank Negara left the policy rate unchanged at 3.25% at its April meeting.
- **Argentina:** The government raised the policy rate to 40%, announced fiscal measures, passed a structural reform and began talks with the IMF following an attack on the currency over the last couple of weeks. Investors should view these responses from the government positively, in our view. The government was largely to blame for the currency crisis by naively hoping to be able to stabilise the economy without fiscal retrenchment. Having now realised the mistake of this approach, there is now a real opportunity for proper stabilisation, which, if the government follows through, should make for a good entry point for fixed income

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Emerging Markets

investors in Argentina. Growth will likely slow due to the measures taken to stabilise the currency and the government may well lose popularity as well, because the IMF is not particularly popular in Argentina. However, the reward for such upfront costs will be a more sustainable recovery. As far as the reform is concerned, Congress last week passed a wide-ranging capital markets reform bill that should help to speed up Argentina's upgrade from frontier to emerging markets status with respect to the MSCI index. The reform should also materially increase the volume of private equity investment by allowing closed-end mutual fund investments in alternative assets like real estate and farmland (both are clear competitive advantages in Argentina).

- Brazil: Former Chief Justice Joaquim Barbosa has withdrawn from the race to become Brazil's next President. Barbosa's departure from the race will probably favour mainstream candidates, such as PSDB's Jose Alckmin, although the election race remains wide open. The election is in October this year. In other news, the main consumer prices inflation index (IPCA) printed a lower than expected 0.22% in April (0.28% mom expected). This means that yoy inflation now tracks 2.76% versus 2.68% in March. Excluding regulated prices, inflation recorded a very low print of 0.1% mom and slowed to 1.0% yoy from 1.3% in March. Broad retail sales expanded strongly in March (1.1% mom, or 7.8% yoy), while core retail sales rose 0.3% mom (6.5% yoy) versus 0.2% mom expected.

- Ecuador: President Lenin Moreno will announce a new Cabinet in the next ten days as he embarks upon his second year in office. Moreno has undertaken a number of market friendly reforms since taking office, which have extracted a political cost. By reshuffling his cabinet, Moreno hopes to replenish his political capital by adding fresh faces and ideas.

- Mexico: The yoy rate of core CPI inflation declined to 3.71% in April from 4.02% in March, which means that inflation has now declined by 1.31% since peaking in early August last year. Industrial production contracted -0.04% in March in seasonally adjusted terms versus +0.4% mom sa in February. The result was significantly better than expected (-0.4% mom sa).

- Philippines: The central bank raised the policy interest rate to 3.25% from 3.0% and indicated that it stands ready to take further action if required. The trade deficit declined to USD 2.6bn in March, which was lower than the Bloomberg consensus expectation of USD 3.0bn and lower than last month's deficit of USD 2.9bn.

Snippets:

- Chile: CPI inflation was 0.3% in April, which was above expectations (0.1% mom). The higher than expected inflation print takes yoy inflation from 1.8% in March to 1.9% in April. Inflation remains below the lower limit of the central bank's 2-4% target range for inflation.
- China: CPI inflation in April moderated sharply to 1.8% yoy from 2.1% yoy in March as the New Year effect began to fade from the data. Inflation remains comfortably below PBOC's 3% target. The yoy rate of credit growth was unchanged at 12% in April.
- Colombia: Fitch maintained Colombia's BBB sovereign credit rating with neutral outlook, reflecting the country's long record of prudent and consistent macroeconomic policies.
- Czech Republic: Inflation in April recovered following downside surprises in recent months. CPI inflation increased from 1.7% yoy in March to 1.9% yoy in line with the Czech National Bank's own forecast.
- India: Industrial production in March expanded at a yoy rate of 4.4%, which was slower than last month (7.0% yoy).
- Indonesia: Bank Indonesia indicated in a statement last week that it stands ready to take measures to limit short-term currency volatility, including further interventions in currency markets and potentially hiking rates.
- Hong Kong: Real GDP growth was the strongest in six and a half years in Q1 2018 (4.7% yoy versus 3.4% yoy expected).
- Peru: The central bank left the policy rate unchanged at 2.75% in line with market expectations.

Global backdrop

Tensions between Israel and Iran sharply increased last week as the two sides engaged in proxy clashes in Syria. This followed in the immediate aftermath of US President Donald Trump's decision to pull the US out of a treaty designed to contain Iran's nuclear ambitions. The US withdrawal happened despite Iran's full compliance with the terms of the treaty. Oil prices received a boost as US sanctions may now limit Iran's ability to export oil, although declines in oil production in Venezuela may also be contributing to the recent rise in oil prices.

Beyond the immediate impacts on the oil market and Israeli-Iranian relations in Syria, the US withdrawal from the Iranian nuclear treaty marks yet another example of America's rapid withdrawal from the international stage under Trump. In addition to the withdrawal from the Iran deal, Trump has also shrunk America's influence in numerous other areas, including the Trans-Pacific Partnership, a global climate change agreement and,

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Global backdrop

most importantly, U-turned on America's longstanding commitment to free trade. The US withdrawal in these areas create economic and political disequilibria on a global scale, which increases uncertainty in the near-term and may have far more serious ramifications – positive or negative – over the longer term. The potential negative consequences include lower US growth rates and deterioration in the global environment. The potential positive implications include the further expansion of China's influence in the world. China currently takes a far more constructive and mature approach to globalisation and the environment than the US, in our view.

Sentiment towards EM stabilised over the past week as investors slowly got their heads around the fact that mere profit taking in EURUSD – the main reason behind a recent surge in the Dollar – is hardly a good reason to liquidate positions in EM. Both EURUSD and EM local markets rallied at a faster than sustainable pace in 2017, but over and undershoots are common in all currency markets and should not lead to major revisions in broader global asset allocation. The pullback in EM markets has increased the appeal of the EM asset class, which was priced attractively even prior to this latest bout of volatility, in our opinion. In addition to the motive of profit taking, markets also pulled back due to concerns over the Iran nuclear treaty and trade tensions between China and the US. In this context, we note that hardly any EM investors are involved in Iran, while trade tensions between China and the US should be relatively contained, in our view.[1] In general, we expect more pullbacks in the coming years as investors slowly come to terms with the unpleasant fact that the markets, which benefited most under Quantitative Easing (QE), such as the Dollar, US stocks and European bonds have far less return potential in the next five years than they had in the previous five years. As the only asset class to cheapen outright during the QE period, we believe EM offers far better return potential than developed markets, wherefore investors should exploit temporary pullbacks to enter the asset class at attractive valuations.

Finally, we note that US core CPI inflation was 0.098% mom in April, which was below the consensus expectation of 0.2% mom. This lower than expected inflation print rendered the yoy rate of US core CPI unchanged at 2.1% and points to a decline in the upcoming core PCE release (the Fed's preferred inflation measure) from 1.9% yoy to 1.8% yoy.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	0.07%	1.06%	19.40%	6.84%	4.88%
MSCI EM Small Cap	-0.94%	-0.87%	15.35%	4.50%	3.84%
MSCI Frontier	-3.93%	-2.35%	14.28%	4.52%	5.86%
MSCI Asia	0.55%	1.91%	21.99%	7.96%	8.02%
Shanghai Composite	2.67%	-4.27%	5.44%	-8.23%	9.67%
Hong Kong Hang Seng	0.13%	5.46%	25.20%	-0.89%	5.74%
MSCI EMEA	0.72%	-2.47%	13.03%	2.73%	-0.06%
MSCI Latam	-3.71%	2.78%	10.28%	4.62%	-2.40%
GBI EM GD	-2.02%	-0.69%	6.09%	3.05%	-2.30%
ELMI+	-0.91%	-0.33%	5.20%	1.98%	-0.86%
EM FX Spot	-1.20%	-2.03%	0.23%	-3.53%	-7.24%
EMBI GD	-0.83%	-3.98%	0.38%	4.49%	3.61%
EMBI GD IG	-0.13%	-3.79%	0.49%	2.78%	2.41%
EMBI GD HY	-1.54%	-4.23%	0.19%	6.45%	5.01%
CEMBI BD	-0.66%	-2.42%	0.97%	3.92%	3.59%
CEMBI BD IG	-0.43%	-2.53%	0.24%	2.57%	2.91%
CEMBI BD Non-IG	-0.94%	-2.27%	1.97%	5.93%	4.45%

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Benchmark performance

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	3.11%	2.72%	16.15%	11.30%	13.10%
1-3yr UST	-0.03%	-0.36%	-0.27%	0.33%	0.46%
3-5yr UST	-0.12%	-1.48%	-1.34%	0.45%	0.67%
7-10yr UST	-0.23%	-3.31%	-2.22%	0.47%	0.76%
10yr+ UST	-0.23%	-5.39%	0.83%	2.25%	2.62%
10yr+ Germany	0.03%	0.05%	0.63%	1.55%	5.06%
10yr+ Japan	0.18%	1.08%	2.47%	4.50%	4.60%
US HY	0.20%	-0.02%	3.30%	5.00%	4.62%
European HY	0.00%	0.13%	3.07%	4.44%	5.88%
Barclays Ag	-0.48%	-0.75%	4.40%	2.40%	1.18%
VIX Index*	-17.83%	18.57%	25.87%	2.75%	2.51%
DXY Index*	0.57%	0.26%	-6.94%	-1.17%	10.49%
CRY Index*	0.78%	5.00%	12.04%	-12.17%	-29.24%
EURUSD	-0.79%	-0.18%	9.18%	5.02%	-7.25%
USDJPY	0.16%	-2.82%	-3.76%	-8.11%	6.92%
Brent	2.58%	15.31%	51.67%	15.80%	-24.84%
Gold spot	0.33%	1.30%	7.22%	8.07%	-7.42%

*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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