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WEEKLY INVESTOR RESEARCH

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The EUR catches a break

By Alexis de Mones and David Muller

After a tumultuous week in Europe that saw new Prime Ministers appointed in both Spain and Italy, the EUR closed the week a few pips higher at USD 1.1659; US steel and aluminium tariffs are back on – and so is steely resolve to retaliate against them; Brazil's government and Petrobras' CEO, pay the price for the truckers' strike; Colombia joins the OECD.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.0	–	-0.51%
MSCI EM Small Cap	12.1	–	0.28%
MSCI Frontier	10.3	–	-1.13%
MSCI Asia	11.7	–	-0.24%
Shanghai Composite	10.7	–	-2.05%
Hong Kong Hang Seng	7.4	–	-0.06%
MSCI EMEA	9.6	–	-0.60%
MSCI Latam	11.3	–	-3.26%
GBI-EM-GD	6.42%	–	-0.08%
ELMI+	4.29%	–	0.05%
EM FX spot	–	–	-0.21%
EMBI GD	6.31%	341 bps	-0.81%
EMBI GD IG	4.85%	195 bps	-0.19%
EMBI GD HY	7.99%	509 bps	-1.44%
CEMBI BD	5.96%	310 bps	-0.23%
CEMBI BD IG	4.87%	201 bps	0.05%
CEMBI BD Non-IG	7.30%	444 bps	-0.58%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.6	–	0.32%
1-3yr UST	2.49%	–	0.13%
3-5yr UST	2.77%	–	0.31%
7-10yr UST	2.92%	–	0.70%
10yr+ UST	3.06%	–	1.53%
10yr+ Germany	0.39%	–	1.72%
10yr+ Japan	0.05%	–	0.16%
US HY	6.41%	356 bps	0.03%
European HY	3.53%	418 bps	-0.12%
Barclays Ag	2.00%	-92 bps	0.06%
VIX Index*	13.46	–	0.93%
DXY Index*	94.06	–	-0.19%
EURUSD	1.1686	–	0.52%
USDJPY	109.64	–	0.20%
CRY Index*	201.71	–	-3.95%
Brent	76.6	–	1.70%
Gold spot	1291	–	-0.60%

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

Emerging Markets

- **Argentina:** In response to continued pressure on its currency, Argentina's Monetary Policy Committee (MPC) maintained its policy rate at the 40% level and reiterated its hawkish bias. The central bank is expected to keep real interest rates high for a while longer in order to try and stabilise the currency. The exchange rate has been drifting towards 25 ARS per USD, a 'line in the sand' level that the central bank is keen to defend, including through sizeable FX intervention. President Macri stated that a deal with the IMF could be reached within the "next few days", while Treasury Minister Nicolas Dujovne is scheduled to meet with IMF officials early in the week. In order to ensure a positive market reception, it is likely that a support package in excess of the initially requested USD 30bn will be presented. The IMF is also likely to mandate more accelerated fiscal adjustments than had been envisioned by the Argentine government.

- **Venezuela:** President Maduro was sworn in quickly after his unsurprising re-election and announced a 60-day postponement of the launch of the new currency, the Bolivar Soberano, which simply knocks three zeros from current bills. Ostensibly, the delay is in response to a request from the country's banking union due to technical reasons, which may reflect an absence of FX to pay for the paper on which the new currency would be printed. A new currency will do little to reign in hyperinflationary pressures as long as the fiscal deficit is financed by the printing press. An estimate of the parallel exchange rate has jumped from 622,000 VEF for one USD at the start of May, to 1,253,000 VEF/USD at the end of the month. Countries continue to react to the recent presidential elections, which have been called "illegitimate and anti-democratic" by the Canadian government and others, through the imposition of additional sanctions and downgrading of diplomatic ties. The Organization of American States (OAS) released a 400-page report charging the Maduro government with "crimes against humanity."

- **Brazil:** Q1 GDP grew at 0.4% qoq (1.2% yoy) in line with consensus, up from 0.2% qoq the previous quarter. This is the fifth consecutive quarterly expansion and reflects the ongoing steady cyclical recovery. The main driver of this recovery remains domestic demand, with private consumption showing its fifth consecutive quarterly growth coupled with the fourth quarterly expansion of investments. Consensus forecasts for 2018 GDP growth stands at 2.4%. The 10-day truckers' strike has led to widespread fuel shortages and could lead to softer data in the Spring but the effects will be transitory.

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Emerging Markets

More importantly, the strike creates more uncertainty about the political outlook, which is the main explanation for the recent fall in the BRL and local bond prices. Beyond the truckers, the general population is also unhappy about the rise in fuel prices and blames the government for the stagnation in living standards. The government did announce a temporary freeze on fuel prizes a week ago, but it under-estimated the groundswell of popular support for the truckers' grievances. Opposition parties of the right and the left both stand to benefit, as support for the centrist parties that make up the government coalition falls further and President Temer's popularity was recorded at a mere 4% in one poll. The freeze in fuel prices pushed the government to announce spending cuts in other programs and increased pressure on Petrobras. Its CEO, Pedro Parente, resigned on Friday afternoon, citing the need for renewed talks on pricing policies. News of the resignation caught the market by surprise, as Parente had used his two-year tenure to return the oil giant to profitability and had scored stunning successes in decreasing the company's debt burden. After a 20% increase earlier in May, the stock dropped 41% in the last two weeks but is still up year-to-date.

- Colombia: Colombian President Juan Manuel Santos and OECD Secretary-General Gurría signed an accession agreement on 30 May, by which Colombia joins Mexico and Chile as the third Latin American country and 37th member of the club of more developed economies. This concludes an accession process that started in 2013 and has been challenging the government to make progress on issues of governance, transparency and inclusiveness. Last week however all the action was in exports data (up a whopping 38.5% in April yoy) and politics: Ivan Duque and Gustavo Petro are facing each other in the presidential election run-off on 17 June. Duque, a conservative upstart handpicked by former President Uribe, is leading with as much as 55% support according to the latest poll by Centro Nacional de Consultoria. If elected, he vowed to amend, but not tear up, the peace agreement concluded with the FARC by President Santos in 2016. He is the market's preferred candidate, and the consolidation of his lead helped the Colombian Peso outperform in the recent Latam sell-off. His opponent Petro, a former rebel himself and ex-mayor of Bogota, had 35% support in the same poll, but he stands to benefit from the support of the left-wing Democratic Pole party, who backed third place finisher Fajardo and who had attracted as much as 24% of the vote in the first round, just a shade below Petro's 25%.

- Turkey: The monetary policy tightening and 'simplification' measures announced by the central bank (CBRT) last week, which saw the effective lending rate re-aligned with the previous late liquidity window rate of 16.50%, provided some temporary respite for the Lira. Apart from the CBRT move, some support came from more supportive global market conditions, notably lower US treasury yields and lower oil prices. The trade balance for April was at a deficit of USD 6.7bn which was in line with expectations. With only 3 weeks remaining before elections on 24 June, the market has shifted its focus to the ramifications of a potential opposition victory in Parliament.

- Indonesia: Indonesia hiked rates twice over the past two weeks and has adopted a more hawkish bias, in response to a sell-off in IDR assets. New Governor Perry Warjiyo showed a willingness to act decisively, convening an additional monetary policy meeting on 30 May, and has shown the seriousness of his objective to stay ahead of the curve as US interest rates continue to rise. Following the second hike, the central bank made clear that it retains a tightening bias in its monetary policy.

Snippets

- Argentina: May Industrial Production was up 3.4% yoy, up from 1.2% the previous month.
- Brazil: The trade balance for May recorded a USD 6bn surplus, level with the USD 6.1bn recorded the previous month; consumer confidence was also unchanged in May at 102.2, but the Manufacturing PMI index dipped to 50.7 from 52.3.
- Chile: Retail sales increased 7.4% yoy in April, the highest gain in retail sales since 2013.
- Kazakhstan: the rate of inflation dropped to 6.2% yoy in May from 6.5% the previous month; it was the lowest inflation rate since September 2015.
- Pakistan: The consumer price index increased 4.2% yoy in May, up from 3.7% the previous month.
- Russia: The Markit Manufacturing PMI fell to 49.8 in May from 51.3 the previous month, the first contraction since July 2016, amid contraction in the employment component and a rise in the inflation gauge.
- South Korea: Q1 GDP rebounded to 1.0% qoq (2.8% yoy), up from -0.2% qoq in Q4 2017. Manufacturing, construction and services all contributed to the increase.

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Global backdrop

Weeks of heightened political uncertainty finally abated in Italy with the appointment of a new coalition government of the Five Star movement and the League, headed by Prime Minister Conte and with Giovanni Tria as Economy Minister. An earlier attempt to form a similar coalition had been scuppered by President Matarella's decision last week to appoint a 'technocratic government' instead, leading to fears that the country was moving towards new general elections in the Fall. The risk of a de facto referendum on the Euro in Italy initially pushed Italian 2-year bond yields over 200 basis points higher and the EUR 1.9% lower to 1.1510 last Tuesday, but the new political solution allowed the EUR to retrace all its losses while Italian BTPs also rallied.

In another twist, a vote of no confidence against the Spanish government, brought about by the Spanish Socialist Party PSOE, gathered enough support by regional parties to topple the Spanish Prime Minister Mariano Rajoy after six years in office, mainly due to a slush fund scandal. The PSOE Party chief Pedro Sanchez was promptly sworn in as Prime Minister following Rajoy's ouster.

In a wide-ranging interview with Frankfurter Allgemein on Sunday, Germany's Chancellor Angela Merkel converged with President Macron of France on certain aspects of his EU reform plans such as a European currency fund and a common investment budget. Angela Merkel is a cautious politician who prefers to react to events rather than shape them, but maybe the risks recently posed by Italy as well as the direct challenge from President Trump on trade can convince her to start using Germany tremendous economic muscle to strengthen the EU's voice.

The week re-opened a recent wound in the so-called trade wars between the US and its trading partners. On Friday, the White House confirmed that the US – as mooted earlier this year - would start imposing metal tariffs against a number of key allies, including NAFTA-partners Canada and Mexico as well as the EU (25% on steel and 10% on aluminium). The US has invoked an unusual "national security" argument, which argues that these imports threaten the US's ability to produce weapons and armored vehicles, and used the threat of tariffs to try to extract trade concessions. In the case of Mexico and Canada, temporary exemptions had been granted subject to these countries agreeing a new NAFTA agreement by 1 June, but Canada walked away when a new 'sunset clause' on any new deal was added to the US list of conditions last week. Justin Trudeau was seething at the fact that Canada, the US' staunchest ally, was targeted on 'national security' grounds, and he announced retaliatory measures against USD 12.8bn worth of imports. Mexico's government also retaliated with its own plan to slap tariffs on flat steels, apples and other food produce.

The new tariffs will affect around 80% of the US steel imports and 95% of the US aluminium imports. Steel and aluminium prices have already been rising in the US since last winter, and so have domestic production costs. There is little support for these tariffs domestically, and the US steel Workers Union themselves have come out against them. The tariffs may end up becoming a massive own-goal for the US, but for Friday's good set of May employment data (which President Trump, in another break with convention, pre-announced on his Twitter feed) which saw payrolls increase by 223k in May and average hourly earnings increased by 0.3% mom (2.7% yoy), helping the 10-year US treasury bond yield move back up to 2.90%, after dropping to a low of 2.76% on risk aversion buying earlier in the week.

Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	0.86%	-1.73%	15.03%	6.95%	5.09%
MSCI EM Small Cap	0.22%	-1.79%	14.30%	3.40%	4.09%
MSCI Frontier	0.20%	-7.49%	5.37%	3.25%	4.06%
MSCI Asia	0.61%	0.64%	17.87%	7.92%	8.38%
Shanghai Composite	-0.64%	-6.67%	1.33%	-12.26%	8.57%
Hong Kong Hang Seng	0.37%	3.48%	18.40%	-1.85%	6.71%
MSCI EMEA	1.50%	-7.38%	7.67%	3.05%	0.00%
MSCI Latam	0.33%	-7.91%	3.90%	3.76%	-3.30%
GBI EM GD	-0.02%	-3.71%	0.59%	2.71%	-1.66%
ELMI+	0.15%	-1.65%	2.26%	1.96%	-0.66%
EM FX Spot	0.00%	-4.43%	-3.69%	-3.59%	-7.00%
EMBI GD	-0.31%	-3.60%	-0.95%	4.49%	4.27%
EMBI GD IG	-0.16%	-3.67%	-0.60%	2.83%	3.31%
EMBI GD HY	-0.47%	-3.60%	-1.41%	6.43%	5.38%
CEMBI BD	-0.19%	-2.64%	0.23%	3.74%	3.97%
CEMBI BD IG	-0.14%	-2.33%	-0.31%	2.58%	3.36%
CEMBI BD Non-IG	-0.25%	-3.01%	1.07%	5.47%	4.74%

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Benchmark performance

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	1.09%	3.13%	14.74%	11.28%	13.20%
1-3yr UST	-0.10%	-0.06%	-0.15%	0.40%	0.54%
3-5yr UST	-0.27%	-0.97%	-1.40%	0.52%	0.88%
7-10yr UST	-0.54%	-2.55%	-2.81%	0.47%	1.26%
10yr+ UST	-1.04%	-4.17%	-0.74%	2.13%	3.52%
10yr+ Germany	-0.60%	2.99%	2.51%	2.17%	5.87%
10yr+ Japan	-0.10%	1.30%	2.04%	4.76%	4.88%
US HY	0.09%	-0.15%	2.33%	4.90%	4.88%
European HY	0.27%	-0.82%	1.75%	3.98%	5.83%
Barclays Ag	-0.34%	-1.36%	1.61%	2.65%	1.27%
VIX Index*	-12.77%	21.92%	38.05%	-8.50%	-17.27%
DXY Index*	0.09%	2.10%	-2.74%	-1.47%	13.64%
CRY Index*	-0.56%	4.05%	13.34%	-9.00%	-29.46%
EURUSD	-0.06%	-2.66%	3.84%	3.99%	-10.66%
USDJPY	0.75%	-2.71%	-0.73%	-11.84%	9.61%
Brent	-1.30%	14.52%	53.31%	23.46%	-25.82%
Gold spot	-0.56%	-0.88%	0.90%	9.72%	-7.74%

*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.

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: +9122 6269 0000

New York
T: +1 212 661 0061

Riyadh
T: +966 11 483 9100

Singapore
T: +65 6580 8288

Tokyo
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