Issued: 30 July 2018

WEEKLY INVESTOR RESEARCH

Ashmore

Just when you thought it was safe to go back in the water…

By David Muller

A rebound in asset price performance provided hope to EM investors that a longer-lasting rebound was underway. Trade tensions between the US and the EU calmed. China signalled looser fiscal policy.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	11.0	–	2.15%
MSCI EM Small Cap	10.8	–	2.29%
MSCI Frontier	10.5	–	1.44%
MSCI Asia	11.6	–	1.86%
Shanghai Composite	10.1	–	1.62%
Hong Kong Hang Seng	7.1	–	3.46%
MSCI EMEA	9.3	–	2.70%
MSCI Latam	11.9	–	3.08%
GBI-EM-GD	6.60%	–	1.06%
ELMI+	4.64%	–	0.81%
EM FX spot	–	–	0.92%
EMBI GD	6.20%	323 bps	0.63%
EMBI GD IG	4.72%	175 bps	0.22%
EMBI GD HY	7.88%	492 bps	1.05%
CEMBI BD	5.93%	299 bps	0.42%
CEMBI BD IG	4.81%	188 bps	0.18%
CEMBI BD Non-IG	7.31%	437 bps	0.70%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	15.9	–	0.61%
1-3yr UST	2.68%	–	-0.07%
3-5yr UST	2.86%	–	-0.25%
7-10yr UST	2.99%	–	-0.45%
10yr+ UST	3.11%	–	-0.97%
10yr+ Germany	0.44%	–	-0.39%
10yr+ Japan	0.10%	–	-1.70%
US HY	6.34%	338 bps	0.32%
European HY	3.40%	411 bps	0.28%
Barclays Ag	2.04%	-95 bps	-0.20%
VIX Index*	13.45	–	0.83%
DXY Index*	94.52	–	-0.11%
EURUSD	1.1683	–	-0.08%
USDJPY	111.10	–	0.23%
CRY Index*	195.72	–	3.23%
Brent	74.9	–	2.57%
Gold spot	1222	–	-0.23%

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

Emerging Markets

In 1975, Director Stephen Spielberg's film 'Jaws 2' introduced one of the most famous taglines in movie history. With the elimination of the feared great white shark at the end of the original 'Jaws' movie, swimmers should have felt totally safe going back into the waters off Amity Island. But were they really safe? In a similar fashion, Emerging Markets (EM) investors have experienced a relief rally heading into the end of the month of July, as trade tensions retreated, the dollar rally reversed course and risk assets turned in a strong performance. But just as moviegoers learned that there's more than one bad shark out there, EM investors are pondering whether the current rally is sustainable or whether more volatility is forthcoming.

Trade tensions remain the clear focus, and the key risk factor, for global investors. This begs the question of how to invest in a period of uncertainty, and whether it is better to take advantage of perceived value opportunities or to pull in one's horns and wait for some element of clarity.

We have learned from past experience that double-digit peak-to-trough drawdowns are not uncommon in bull markets for EM assets. In the current environment, we see growth still improving, fiscal policy tightening and positioning much cleaner, all attributes which indicate to us that the correction in EM assets experienced thus far in 2018 is more a reaction to broader concerns about global growth, interest rate trajectory and trade policy. There are certainly several idiosyncratic country risk stories in EM, but we argue that investors are being presented with an opportunity to add to, or to initiate, allocations at levels last seen in 2016 at the start of a 2-year rally in EM assets. There are clear indications that some investors are heeding the message, with the third consecutive week of inflows to EM after 11 consecutive weeks of outflows, according to EPFR .

- China: The Chinese government has signalled looser fiscal policy, a commitment to supporting the economy in response to external uncertainty. At the conclusion of the State Council meeting, the government announced that domestic demand would be stimulated through further adjustment of monetary and fiscal policy. Specifically, additional tax cuts would be introduced to augment the various tax relief measures that had been launched during the first half of 2018. Easing of domestic liquidity conditions would supplement plans to stabilise broad credit growth. Chinese commercial banks were advised by the PBOC (People's Bank of China,

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Emerging Markets

the central bank) that MPA (Macro Prudential Assessment) requirements would be relaxed. Having been introduced in 2016, MPA rules limited commercial bank activity through imposition of a complex formula, which is to be amended to give banks more flexibility in their lending, thereby boosting credit growth. Increased credit extension by the banking sector should support overall economic activity and growth. The market will focus on the nature and rationale for the easing move. It is, to a certain extent, a reaction to the risks stemming from ongoing trade tensions, augmented by the contribution of a weaker RMB. To date, the PBOC appears comfortable with both the direction and the magnitude of the looser policy.

- Argentina: positive trends in consumer confidence and currency stability are encountering increased concerns about a potential recession in 2018, defined as two consecutive quarters of negative growth. GDP in May came in at -5.8% yoy and April's GDP was revised down to -0.6%. The drop, not unexpected following the recent balance of payments crisis, reflects a decline in agricultural production due to an ongoing drought, exacerbated by a tightening of domestic and external financing conditions, tighter fiscal policy and high inflation. Q1 saw GDP growth of +3.6% yoy, but the outlook for Q2 and Q3 is less encouraging. In a sign that confidence is returning to the market, the government was able to roll over most of its dollar Letes coming due at rates lower than in the prior auction.

- Brazil: Political party conventions commenced on 20 July and will continue until 5 August, with the campaign registration period open until 15 August. Four candidates – Alckmin, Bolsonaro, Gomes and Silva – appear to be the most competitive. Jailed former president Lula still aims to participate in the election, but the probability of his candidacy being barred remains quite high. Five centrist parties agreed to back centre-right candidate and former 4-term governor of Sao Paolo Geraldo Alckmin, which would give him significant TV time based on elector rules that allocate TV time based on the number of legislators in the candidate's party coalition. This wide exposure is likely to boost Alckmin, who is polling in 4th place behind former Ceara State Governor Ciro Gomes, environmentalist and former Senator Marina Silva, and front-runner Jair Bolsonaro, a far-right nationalist who is seen as benefitting from voter anger at the political establishment.

- Colombia: The central bank held the key interest rate steady at 4.25% at its July meeting, and will likely remain on hold for the balance of the year in light of short-term inflationary pressure and an improving economy. In the political world, former president Alvaro Uribe (2002 – 2010) resigned his seat in the Senate after the Supreme Court acknowledged it was expanding its criminal investigation to include charges of bribery. As one of the country's most popular politicians, Uribe had battled with his successor, and was rewarded when his protégé Ivan Duque won the presidency in June. In an ironic twist, the new charges against Uribe could enable Duque to truly be his own master as he assumes the presidency.

- Mexico: President-elect AMLO spoke by telephone with President Trump, after which Trump called him a "terrific person" with whom he is working on something "very dramatic, very positive" for both countries. AMLO commented that he is open to a trade deal, but is unaware of anything dramatic. Mexico is hoping for completion of NAFTA renegotiations by the end of August in order to permit a shift in focus by the new administration to the domestic agenda. Economy Minister Guajardo and the transition team's NAFTA negotiator Seade were in Washington at week end. Mexico's stated objective is to conclude tripartite talks with its NAFTA partners, rather than the bilateral agreement that had been discussed by US negotiators.

- South Africa: In a major boost to South Africa's President Ramaphosa's ambitious 5-year USD 100bn investment programme, China pledged to invest USD 14.7bn, following similar USD 10bn pledges from both Saudi Arabia and the United Arab Emirates. President Xi Jinping made the pledge on arrival in Johannesburg for the 10th summit of BRICS nations. Troubled state electric company Eskom received a USD 2.5bn loan from the China Development Bank, helping to complete more than 2/3 of the company's financing needs for 2018. Eskom announced plans for a new government-guaranteed bond, which should complete the year's fundraising.

- Pakistan: Elections were held on 25 July for Prime Minister, in a vote that was only the second transition from one civilian government to another in the country's 71 year history. To date, however, no PM has completed the entire 5-year term to which he/she had been elected. The election was won by former cricket star Imran Khan and his PTI party, taking more seats than expected but falling short of a majority. PTI should be able to form a coalition government with Khan as PM, removing concerns about a hung parliament. A strong mandate for PTI should translate into decisive leadership, hopefully on the economic front, and could lead to renewed engagement with the IMF. Claims of ballot-rigging surfaced as the election results were being announced, which could translate into street protests. The current governing party – the Pakistan Muslim League – Nawaz (P.M.L.-N.) – has complained of interference and pressure on its leaders to defect to other parties by the military. The party is led by Shehbaz Sharif, brother of former PM Nawaz Sharif, who was convicted of corruption and is currently in prison. Another actor to watch is Bhutto Zardari, the son of assassinated PM Benazir Bhutto and former President Asif Ali Zardari, and the grandson of former PM Zulfiqar Ali Bhutto, who was executed.

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Emerging Markets

- **Turkey:** In a major surprise, Turkey's central bank (CBT) ignored market expectations and kept the one-week repo rate steady at 17.75%. The market had been expecting a 100bps hike in a move seen as critical to boost the CBT's credibility. The decision ignored a deterioration in inflation expectations. As there is no policy meeting in August, the decision leaves Turkey's monetary policy in a state of limbo. The MPC indicated that policy is likely to remain tight for an extended period, and could be tightened further. The decision had an immediate impact on the country's currency, as the TRY dropped 3% and long-end yields rose more than 100bps, largely reversing the prior week's rally. With inflation unlikely to reverse course in the near future, rates will need to stay elevated, but concerns abound on whether the government will be capable of making the necessary fiscal adjustments to remain credible with international lenders who are critical in order to meet the country's external financing needs.

Snippets:

- **Brazil:** June's USD 0.44bn current account surplus contrasted with a USD 1.33bn surplus in June 2017. The country saw a USD 9.6bn capital account surplus for 1H 2018 despite a monthly deficit of USD 3.1bn in June. FDI inflows were strong at USD 6.5bn in June.
- **Chile:** BCCH (the Chilean central bank) kept rates steady at 2.5% but with a slightly hawkish tilt, noting that growth continues to accelerate and inflation is edging upwards. The bank indicated that the policy rate will return to neutral, i.e. higher, levels 'within the next few quarters'.
- **Dominican Republic:** The Central Bank (CBRD) hiked policy rates by 25bps to 5.5% in an unexpected move. The action was attributed to rising inflation expectations reflecting higher oil prices and increased domestic demand pressures. Headline inflation, at 4.63% yoy in June, remain above the midpoint of the target band.
- **Ecuador:** Comments from Finance Minister Martinez and Trade Minister Campana imply that conversations regarding a deal with the IMF may be forthcoming. With required lead-time, this could be a 2019 event, but would serve to diversify the country's funding sources.
- **Hungary:** Policy rates were maintained at 0.9% and forward guidance was unchanged. The National Bank of Hungary (NBH) believes the rise in CPI to be temporary and sees inflation returning to the 3% target by mid-2019.
- **Nigeria:** The CBN (Central Bank of Nigeria) held the policy rate steady at 14% but noted that a tightening move was 'strongly considered'. It is important to note that the policy rate is non-binding and does not determine the country's interest rates. Rather, the CBN targets monetary aggregates and adjusts short-term liquidity accordingly.
- **Philippines:** The central bank (BSP) indicated that 'strong monetary action' would be likely at the 9 August meeting of the Monetary Board. Upward pressure on CPI will therefore likely be met by policy tightening. BSP could hike by 50bps with a new year-end target of 4.25% for policy rates.
- **Russia:** The central bank (CBR) kept rates steady at 7.25% at the July meeting of the MPC. While inflation remains low at 2.3% yoy, the bank expects inflation to accelerate and to reach the 4% target in 2019. However, a further cut during 2018 remains possible.
- **South Korea:** Q2 GDP moderated to 0.7% qoq, down from 1% in the prior quarter, largely due to weaker domestic demand that was at the lowest level since Q3 2012. The slowdown could necessitate more cautious action by the Bank of Korea at its August meeting.

Global backdrop

European Commission President Jean-Claude Juncker journeyed to Washington armed with colourful cue cards with 'simplified' explanations on trade for his meeting with President Trump. According to the *Wall Street Journal*, the cards were used to explain trade to the president so as to avoid any confusion. The strategy was successful, as the two sides de-escalated the trade dispute with an agreement to negotiate tariff reductions and to increase US agricultural exports to the EU. This agreement reduces the possibility of US tariffs on auto imports. While this entente between the US and the EU could be a positive sign, there have been prior announcements that ended in failed negotiations, most notably earlier ones with China. One possible outcome is an emboldened Trump who will use the threat of punitive tariffs in order to extract concessions from its trading partners. This is definitely a 'stay tuned' message, pending the outcome of actual negotiations.

As expected, the ECB Governing Council kept its policy stance unchanged at its July meeting. Current economic data is largely in line with the macroeconomic projections made in June. The accompanying statement noted that, while the economic outlook for the region is balanced, broader global factors now pose the most significant downside risk.

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Benchmark performance

Emerging Markets	Month to date	Year to date	1 year	3 years	5 years
MSCI EM	2.72%	-4.05%	4.88%	9.92%	5.42%
MSCI EM Small Cap	1.65%	-6.89%	3.66%	6.24%	4.37%
MSCI Frontier	4.28%	-7.10%	2.87%	4.40%	4.33%
MSCI Asia	1.50%	-3.32%	5.83%	10.40%	8.09%
Shanghai Composite	1.89%	-11.26%	-9.51%	-6.32%	9.87%
Hong Kong Hang Seng	1.65%	-2.29%	5.69%	3.47%	6.54%
MSCI EMEA	3.52%	-7.63%	2.98%	4.56%	0.41%
MSCI Latam	10.37%	-1.78%	2.67%	9.87%	-0.44%
GBI EM GD	1.98%	-4.59%	-2.35%	3.46%	-1.09%
ELMI+	0.86%	-2.57%	-0.28%	2.48%	-0.74%
EM FX Spot	1.47%	-5.07%	-5.26%	-2.68%	-6.89%
EMBI GD	2.72%	-2.65%	0.24%	5.67%	5.28%
EMBI GD IG	1.62%	-2.11%	0.22%	4.13%	4.32%
EMBI GD HY	3.86%	-3.30%	0.10%	7.41%	6.32%
CEMBI BD	1.35%	-1.56%	0.48%	4.44%	4.76%
CEMBI BD IG	0.92%	-1.20%	0.03%	3.22%	4.12%
CEMBI BD Non-IG	1.88%	-1.99%	1.18%	6.28%	5.61%

Global Backdrop	Month to date	Year to date	1 year	3 years	5 years
S&P 500	3.80%	6.55%	16.08%	13.19%	13.04%
1-3yr UST	-0.05%	0.01%	-0.22%	0.37%	0.54%
3-5yr UST	-0.25%	-0.99%	-1.54%	0.40%	1.00%
7-10yr UST	-0.60%	-2.55%	-2.59%	0.44%	1.84%
10yr+ UST	-1.59%	-4.54%	-0.60%	1.70%	4.48%
10yr+ Germany	-0.66%	3.22%	5.02%	3.20%	6.30%
10yr+ Japan	-1.23%	0.30%	1.32%	4.06%	4.73%
US HY	0.92%	1.08%	2.46%	6.34%	5.29%
European HY	1.54%	0.02%	1.72%	4.49%	6.00%
Barclays Ag	-0.17%	-1.63%	0.01%	2.44%	1.17%
VIX Index*	-16.41%	21.83%	30.71%	10.88%	0.45%
DXY Index*	0.05%	2.60%	1.35%	-3.12%	15.51%
CRY Index*	-2.33%	0.96%	7.47%	-4.39%	-30.52%
EURUSD	-0.01%	-2.68%	-1.34%	6.87%	-11.91%
USDJPY	-0.31%	1.43%	-0.76%	11.74%	-11.76%
Brent	-5.66%	12.07%	42.69%	40.57%	-29.90%
Gold spot	-2.47%	-6.23%	-3.76%	12.21%	-7.89%

*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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