Issued: 30 May 2013

WEEKLY INVESTOR RESEARCH

Ashmore

Summary

Global market sentiment remains extremely volatile on account of continuing uncertainty surrounding the outlook for US monetary policy. Dollar bullishness and treasury market bearishness gave way to dollar weakness and a partial recovery in US treasuries later in the week. The reasons why the uncertain outlook for US monetary policy creates so much commotion are two-fold: First, asset price valuations in HIDC (Heavily Indebted Developed Countries) markets are extremely dependent on continued monetary stimulus. Secondly, HIDC economies are saddled with very high levels of debt and unresolved issues weighing on their ability to grow. The high levels of uncertainty also pushed Emerging Market asset prices lower over the past week.

Global

One of the features of the current global macroeconomic environment is that fast money chases 'good stories' in the HIDC markets, regularly pushing valuations in those markets well beyond what can be justified by fundamentals. Corrections therefore become inevitable and it often takes very little to spook markets once valuations have become excessive. The resulting volatility can be negative for Emerging Market asset prices, although such 'collateral damage' onto Emerging Market asset prices tends to offer excellent opportunities to top up on existing Emerging Markets exposures, albeit always with a careful eye to credit selection within the growing universe of Emerging Market investment opportunities. Thus, the three most popular HIDC trades of the past few months – long US stocks, long Japanese stocks, and long USDJPY – all performed poorly over the past week. US stocks declined by 1.3%, while the Nikkei 225 sustained a much larger fall, dropping more than 5% this today. USDJPY also declined from a 102 handle to a 100 handle. Reason: A more vocal US Fed. The possibility of tapering off the pace of Quantitative Easing is central to the current volatility. The sensitivity of the most popular HIDC trades to talk of normalisation of monetary policy in the US, even at this extremely early stage of the process, underlines the speculative nature of these trades. The underlying reason for fragility, however, is fundamental weakness. All the HIDCs are burdened with extreme levels of debt.

Indeed, in the past week the European Commission announced that it is easing fiscal targets across the Eurozone. Debt is the 'elephant in the room' of the HIDCs. As long as interest rates remain low most ignore the debt. But tighter monetary policy and resulting higher yields will make it impossible to continue to ignore the debt, in our view, eventually bringing the market face to face with the central question in this and any fiscal crisis the world has ever known, namely: who is going to pay?

Turning to the other global markets, EUR maintained its value against the dollar at around 1.2970. US treasury yields rose sharply, briefly reaching 2.23% before falling back to 2.12%. VIX, the index of stock market volatility, rose from 13.08 to 14.80. Oil prices fell about $2. Emerging Market stocks fell 1.6%, while local bonds gave up 1.4% in the context of higher US treasury yields. Emerging Market currencies fell 0.5%, while in US dollar denominated sovereign debt spreads widened 11bps to 272bps over US treasuries and US dollar denominated corporate high yields bond spreads increased by 7bps to 500bps over US treasuries.

Latin America

Brazil's central bank raised interest rates by 50bps to 8%. This was a bigger increase in policy rates than the market has expected and took place against a backdrop of relatively soft growth. For example, this morning it was reported that Brazil's growth rate in Q1 2013 was 2.2% annualised, somewhat softer than consensus expectations. The rate hike thus underlines the political sensitivity of inflation in Brazil (and other Emerging Market countries). It also shows that Brazil, like other Emerging Market countries, is beginning to understand that there are severe limitations in the shape of slower growth, inflation, or asset market bubbles to trying to block currency appreciation through intervention and/or controls. Once the adverse symptoms appear the political imperative to maintain low inflation and to sustain healthy growth rates takes precedence, leading to a return to more orthodox policies, in our view. Elsewhere in Latin America, **Mexican**

Continued overleaf

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Latin America (continued)

inflation declined 0.35% in the first week of May as the government announced that it aims to unveil a plan for how to deal with the troubled homebuilder sector. Peruvian GDP in Q1 2013 rose at a pace of 4.8% yoy. Argentinian Industrial Production was up 1.7% in April versus 2.1% expected.

Asia

Q1 growth in the Philippines was much stronger than expected. On a yoy basis, the economy expanded 7.8% in real terms versus 6.2% yoy expected. The stronger pace of economic expansion also had positive ramifications for the public sector's finances as the latest budget numbers showed that the budget surplus was 19% larger than at the same time last year. In South Korea, Industrial Production rose by 0.8% mom, which was stronger than expected (0.5% mom). In China, the CNY fixed at a new high against the US dollar of 6.1867. Industrial earnings in China for the month of April were stronger than expected, rising 9.3 yoy, up from 5.3% in March, though China's PMI fell marginally below 50 as the global manufacturing downturn continues. In Vietnam, CPI inflation fell to 6.4% in May from 6.6% in April. Singapore's inflation rate in April was 1.5%, which was much lower than expected (3.0%). The fall in inflation took place against stronger than expected growth in the first quarter of 1.8% qoq (seasonally adjusted annualised rate). The central bank in Thailand cut interest rates by 25bps.

Eastern Europe, Africa, and Middle East

Hungary's central bank cut interest rates by 25bps to 4.5% as the country appears to move closer to an exit from the European Union's excess deficit procedure. Economic activity in Russia rose at a higher than expected pace of 2.6% in April. The equivalent figure was 2.0% in March and 1.6% in Q1. South Africa's GDP disappointed at 1.9% yoy in Q1 compared to 2.2% expected, but the South African central bank left rates unchanged at 5%. Polish retail sales declined 2.7% mom in April versus an expected monthly decline of 1% mom, but Q1 growth was higher than expected at 0.5% yoy.

Contact

Head Office

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

Other Locations

Beijing
T: +86 10 5764 2601

Bogota
T: +57 1 347 0649

Jakarta
T: +6221 2953 9000

Istanbul
T: +90 212 349 40 00

Melbourne
T: +61 0 3 9653 9524

Moscow
T: +74 9566 04258

Mumbai
T: +91 22 6608 0000

New York
T: +1 212 661 0061

Sao Paulo
T: +55 11 3556 8900

Shanghai
T: +86 21 3855 6766

Singapore
T: +65 6580 8288

Tokyo
T: +81 03 6860 3777

Washington
T: +1 703 243 8800

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