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WEEKLY INVESTOR RESEARCH

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The Nagorno-Karabahk conflict escalates

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The Nagorno-Karabahk conflict escalated further. Russia and China announced that coronavirus vaccines will be delivered to their own populations and to some EM countries this year. Argentina announced measures to boost US dollar (USD) inflows. Economic data surprised to the upside both in China and India. Brazilian credit expanded as the government toyed with the idea of dangerous 'creative accounting' to boost social benefits. The International Monetary Fund announced a USD 6.6bn new loan to Ecuador with USD 2.0bn to be disbursed immediately. Egypt said Amazon is considering a factory in the country. The Venezuelan government proposed legislation to boost private sector participation in the oil industry. The South African unemployment rate declined albeit for the wrong reason.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.2	–	2.19%
MSCI EM Small Cap	11.7	–	2.96%
MSCI Frontier	12.3	–	-1.12%
MSCI Asia	14.2	–	2.28%
Shanghai Composite	12.4	–	-1.88%
Hong Kong Hang Seng	8.1	–	-1.63%
MSCI EMEA	9.5	–	2.45%
MSCI Latam	11.8	–	-1.80%
GBI-EM-GD	4.48%	–	0.71%
ELMI+	1.75%	–	0.79%
EM FX spot	–	–	0.77%
EMBI GD	5.15%	437 bps	0.14%
EMBI GD IG	2.94%	211 bps	0.40%
EMBI GD HY	8.21%	748 bps	-0.18%
CEMBI BD	4.58%	402 bps	0.22%
CEMBI BD IG	3.05%	249 bps	0.10%
CEMBI BD Non-IG	6.75%	618 bps	0.39%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.9	–	1.54%
1-3yr UST	0.13%	–	-0.01%
3-5yr UST	0.28%	–	-0.06%
7-10yr UST	0.70%	–	-0.24%
10yr+ UST	1.50%	–	-1.24%
10yr+ Germany	-0.53%	–	0.01%
10yr+ Japan	0.00%	–	-0.03%
US HY	5.69%	510 bps	0.89%
European HY	4.60%	547 bps	0.70%
Barclays Ag	0.91%	21 bps	0.37%
VIX Index*	27.63	–	1.25%
DXY Index*	93.78	–	-0.50%
EURUSD	1.1727	–	0.61%
USDJPY	105.58	–	-0.02%
CRY Index*	144.12	–	-4.24%
Brent	40.1	–	-5.42%
Gold spot	1892	–	0.94%

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

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- **Armenian-Azerbaijani conflict:** The disputed Nagorno-Karabahk region bordering Armenia and Azerbaijan, also known as Arsakh, was under constant shelling during the weekend. The origin of the conflict dates back to 1920, when the region was declared an autonomous administrative entity (oblast) of the Soviet Union by Joseph Stalin. Stalin decided to give Arsakh to Azerbaijani control in the hope that it would push Turkey to side with Russia in confronting the West. The region had previously been promised to the independent Republic of Armenia. After the collapse of the Berlin wall, the Armenian majority living in the region started a campaign to transfer control of Arsakh back to Armenia. Armed conflict ensued from 1992 to 1994, when a cease-fire was reached. However, the territorial dispute was never settled with occasional fighting erupting between the two countries. Since then, Armenia has also been controlling areas adjacent to Arsakh, which are internationally recognised as Azerbaijan territory.

Russia supports Armenia and has a military base in the northwest of the country near both Georgia and Turkey. Azerbaijan is supported mainly by Turkey which import large amounts of energy from the country. A pipeline which channels gas from Azerbaijan's capital Baku to the Turkish port of Ceyhan and the Georgian capital of Tbilisi passes only a few kilometres away from the disputed zone. Israel also tends to side with the Azeris as Israel benefits from energy imports and military equipment exports to Azerbaijan.

Last Sunday, Azerbaijan claimed that Armenia bombed the city of Ganja, which is the second largest city in Azerbaijan. Russia, France and the US have been working to mediate a cease-fire, but Turkey's President Recep Tayyip Erdogan has openly opposed it, vowing to fight until the Armenian occupation is over. There are new

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Emerging Markets

reports that Syrian militants have been killed in the region, fighting on the Armenian side. In the Syrian conflict, Turkey managed to impose its objective of displacing the Kurdish population from Turkey's border with Syria. If Russia and the Western allies take too long to intervene, Armenians may be driven from Arsakh and/or its adjacent territories, creating a refugee crisis, which could have wider regional implications.

- Coronavirus in EM: Russian news channel Itar-tass reported that mass vaccinations against coronavirus are expected to start in Russia in late October. In Brazil, the Governor of the Sao Paulo state Joao Doria said that healthcare professionals would have access to a vaccine produced by Sinovac, a Chinese pharmaceutical giant, from 15 December this year. The vaccine will then be produced in Sao Paulo in a partnership with the Butantan Insitute starting in 2021). US pharmaceutical company Moderna said its coronavirus vaccine is unlikely to be ready ahead of the US election scheduled for 3 November 2020.

- Argentina: The rate of real GDP growth was -19.1% on a yoy basis in Q2 2020. The current account posted a USD 462m deficit in August after an USD 820m surplus in the same month of 2019 as the trade surplus narrowed to USD 336m versus USD 2,024m in the corresponding month last year. The poor performance of the external accounts reflects incentives for the private sector to boost imports in order to reduce excess holdings of local currency in the absence of Dollars, which are being hoarded by exporters. On Thursday last week, the government announced measures intended to boost USD inflows, including temporary cuts in taxes on exports of soybeans from 33% to 30% and biodiesel exports from 30% to 26%. The government also announced tax incentives to small soybean producers and tax cuts for manufacturing exporters. On the monetary side, the central bank will allow the Argentinian peso to fluctuate within a wider band, thus allowing for faster currency depreciation. The overnight repo rate was also increased by 5% to 24%. However, we believe that the measures are unlikely to significantly increase the availability of FX reserves, since overall macroeconomic conditions remain deeply imbalanced with the monetary base growing at a yoy rate of 70%. Tight capital controls also remain in place. The new measures do little to increase private sector confidence in a government that has intervened in essential parts of the economy and remains focused mainly in clearing court cases against former President and current Vice President Cristina Fernandez de Kirchner.

- China: The manufacturing PMI survey rose to 51.5 in September from 51.0 in August and the non-manufacturing PMI increased to 55.9 from 55.2 over the same period. In corporate news, Volkswagen and three local joint ventures announced plans to invest EUR 15bn in electric vehicles in China between 2020 and 2024. Evergrande, a property developer, reached agreement with its most strategic investors to cancel a put option set to expire in January 2021, thus averting a potentially challenging liquidity situation.

- India: Economic activity continues to recover as energy demand, vehicle registration, and rail freight all rose in September as the manufacturing PMI survey rose 4.8 points to 56.8. The current account surplus jumped to USD 19.8bn in Q2 2020 from USD 0.6bn in Q1 2020. The record high quarterly surplus was due to a sharp decline in the merchandise trade deficit to USD 10.0bn, which is a 15-year low. Meanwhile, the surplus on the services balance increased to USD 20.5bn. Exports rose at a yoy rate of 5.3%, which is the first positive reading since February.

- Brazil: Total outstanding credit grew 1.5% in the month of August, which is roughly the same pace as in July. Details were encouraging as credit spreads tightened and small companies reported increased availability of loans. Formal job creation rose to 249k in August from 131k in July, although the unemployment rate rose to 13.8% from 13.3% over the same period. Net debt/GDP rose to 60.7% in August from 60.2% in July after the government reported a BRL 96.1bn deficit in August. This was slightly better than the consensus expectation thanks to higher tax collections. However, Brazilian assets still managed to underperform last week as the government revived the direct transfer programme ('Renda Cidadã'), which will be funded by delaying other payments (notably court-mandated settlements of so-called 'precatorios'). Similar policies were pursued by ex-President Dilma Rousseff (*'pedaladas'*). A few years later they became the pretext for her impeachment as they were framed as breaches of the fiscal responsibility law. Finance Minister Paulo Guedes denied the intention to fund the programme by delaying payments of the 'precatorios' as this would imply that the government runs arrears to fund a permanent increase in expenditure. However, so far Guedes has not been able to clarify how to fund the project as Congress continues to object to tax increases.

- Ecuador: The IMF approved a USD 6.6bn 3-year new Extended Fund Facility programme, which embeds an immediate disbursement of USD 2.0bn. This allows the government to settle local arrears, while also strengthening FX reserves. Additional disbursements of USD 2.0bn, USD 1.5bn, and USD 1.0bn are scheduled for December 2020, and 2021 and 2022, respectively. Meanwhile, the yoy rate of real GDP growth contracted 12.4% in Q2 2020, which was better than most Latin American peers.

- Egypt: The US internet retail giant Amazon said it is considering the establishment of a manufacturing hub to produce white label goods in Egypt. The factory would serve as an export hub to the wider Middle East and North Africa region. The government issued a USD 750m green bond to finance sustainable projects. This is the first green bond in the region.

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Emerging Markets

- Venezuela: In an attempt to circumvent sanctions, President Nicolas Maduro proposed legislation that will allow private companies greater ownership shares in joint ventures with state oil company PDVSA. The bill also allows expropriated companies to be returned to their original owners as long as production is quickly restored. Meanwhile, Henrique Caprilles, an opposition leader, called for the postponement of parliamentary elections scheduled for 6 December due to the lack of institutional guarantees about the integrity of the voting process as well as the precarious situation due to the coronavirus outbreak.

- South Africa: The unemployment rate dropped to 23.1% in Q2 2020 from 30.1% in Q1 2020. However, the decline was due to the fact that the labour force dropped to 18.4m people from 23.5m over the same period. Total employment contracted at a yoy rate of 13.3% in Q2 2020 as the labour market shed 2.2m jobs. The rate of consumer prices index (CPI) inflation declined to 3.1% on a yoy basis in August from 3.2% in July, while the rate of core inflation rose to 3.3% yoy from 3.2% yoy over the same period.

- Kuwait: Emir Sheikh Sabah al-Ahmad al-Jaber al-Sabah passed away last week. The emir was much admired as he was credited with putting together the global coalition that liberated the country following the Iraqi invasion of 1990. More recently, the emir supported Qatar during the Saudi-UAE embargo. The Central Bank of Kuwait re-affirmed its commitment to maintaining the country's exchange rate peg to the USD.

- Hungary: Manufacturing PMI declined to 48.8 in September from 52.3 in August. However, the unemployment rate declined to 4.6% in August from 4.8% in July as gross wages increased at a yoy rate of 10.8% in July versus 15.6% yoy in the previous month. The deceleration in wage growth occurred as a result of the termination of one-off health care bonus payments that were introduced in June.

Snippets:

- Chile: Retail sales expanded at a yoy rate of 2.8% in August after a 17.4% yoy contraction in July. However, manufacturing and industrial production contracted at yoy rates of 8.2% and 4.8%, respectively in August. As such, both were weaker than consensus expectations.
- Czech Republic: The government announced tighter social mobility measures to reduce the coronavirus transmission rate.
- Indonesia: The yoy rate of CPI inflation declined to 1.4% in September from 1.3% yoy in August while core CPI inflation declined to 1.9% yoy from 2.0% yoy over the same period.
- Kenya: The central bank kept its policy rate unchanged at 7.0%. The yoy rate of CPI inflation declined to 4.2% in September from 4.4% yoy in August.
- Nigeria: Congress approved the 2021 budget with a projected fiscal deficit of 3.6% of GDP. The Budget assumes oil production at a reasonable 1.86m barrels of oil per day and prices at USD 40 per barrel.
- Philippines: The Central Bank of Philippines kept its policy rate unchanged at 2.25%.
- Saudi Arabia: In his pre-budget statement, Saudi Arabia's Finance Minister said the government is expecting oil prices to average USD 50 per barrel over the next three years.
- South Korea: Industrial production declined 0.7% in August after rising 1.9% in July and 7.1% in June. Daily exports declined at a yoy rate of 4.0% in September.
- Sri Lanka: Moody's downgraded Sri Lanka's sovereign debt credit rating to Caa1 with a stable outlook citing higher liquidity risks and limited funding sources. Public debt is set to exceed 100% of GDP in 2020.
- Thailand: The yoy rate of CPI inflation declined to -0.7% in September from -0.5% yoy in August.
- Turkey: The yoy rate of CPI inflation was unchanged at 11.8% in September, while core CPI inflation rose 30bps to 11.3% yoy. Producer Prices Index (PPI) inflation soared to 14.3% yoy from 11.5% yoy.
- Vietnam: The US Trade Representative announced the initiation of a Section 301 investigation to determine if the Vietnamese Dong (VND) is manipulated to be too low. Vietnam's FX reserves rose from USD 49bn at the end of 2017 to USD 83bn in 1H 2020 during which period VDN weakened 2.2% versus the US dollar.
- Zambia: The Minister of Finance presented a proposal to bondholders stating that the debt to GDP ratio is 104%. A group of bondholders, which jointly hold more than 25% of outstanding bonds, said it would not consent to coupon deferral as requested by Zambia.

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Global backdrop

- **US:** Anecdotal evidence suggests the employment situation may deteriorate as leading companies, including Disney, Continental, Shell, Dow, Goldman Sachs, and Allstate all announced layoffs last week. The September labour market report disappointed as 661k new jobs were created, which was lower than expected. The disappointment was due to 281k layoffs in state and local public education sectors. The unemployment rate declined to 7.9%, but mainly because people opted to leave the workforce. Permanent unemployment rose to 3.8m in September from 3.4m in August. The ISM manufacturing survey slowed to 55.4 in September from 56.0 in August.

Against this backdrop, consumption indicators have held up better than expected. Credit card spending from customers of Bank of America Merrill Lynch increased by 2.3% on a yoy basis in the week ending 26 September. Durable goods purchases were 66% higher than January levels. This implies that the USD 300 per week in unemployment insurance payments provided by the US government have been sufficient to support spending, wherefore any further increase in direct transfer to the population associated with a future fiscal stimulus may end up as higher savings, which in turn are deployed into the equity market.

In the political space, the first presidential debate between President Donald Trump and former Vice-President Joe Biden descended to a shouting match as Biden reacted to Trump's attacks in a similar tone. The low level of the debate underlines the very low importance given to specific policy proposals ahead of an election, which is most likely to be decided by swing voters in a small number of states. These voters will be bombarded with social media targeted advertising. Last Friday, President Trump, his wife, and several close advisors were diagnosed with coronavirus leading to a sharp increase in market volatility. The President was rushed to a military hospital on Friday, but is expected to be discharged soon after taking a steroid recommended only in severe cases. In addition to the members from the president's team of advisors, three Republican senators, including former New Jersey Governor Chris Christie and Senator Ron Johnson were also diagnosed with covid-19. Leader of the Senate Mitch McConnell suspended sessions until 19 October, but the hearings to confirm Amy Coney Barrett's Supreme Court nomination will carry on as normal.

The impact of Trump's illness on the election result is uncertain. On one hand, Trump may benefit from sympathy. On the other hand, it is now obvious that the president disdain for the seriousness of the coronavirus outbreak was reckless. Moreover, Trump has been forced to cancel important campaign rallies and fundraising in the coming days. Two polls collected after the presidential debate, but before the President's diagnosis show that Joe Biden is leading by more than 10%.[1] Importantly, a poll released by The New York Times shows Biden leading by 5 points in Florida. House Representative Leader Nancy Pelosi said that Trump's illness changed the political calculation for approving a fiscal spending bill, probably by shifting the marginal propensity of Republican Party members to accept greater fiscal spending. Over the short term, equity markets may receive a shot in the arm if a fiscal stimulus is approved before the US election.

- **EU:** The flash core CPI inflation rate declined 0.1% in September, thus bringing the yoy rate of core CPI to -0.3% from -0.2% in August.

[1] See https://www.reuters.com/article/us-usa-election-poll/biden-leads-by-10-points-as-majority-of-americans-say-trump-could-have-avoided-coronavirus-reuters-ipsos-poll-idUSKBN26P0DB and https://www.cnbc.com/2020/10/04/2020-election-news-biden-leads-trump-in-nbc-wsj-poll.html?__source=newsletter%7Cbreakingnews

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Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.02%	0.02%	-0.94%	12.17%	2.72%	9.04%
MSCI EM Small Cap	0.41%	0.41%	-1.81%	8.40%	-0.75%	4.65%
MSCI Frontier	0.11%	0.11%	-8.54%	-1.70%	-1.82%	3.85%
MSCI Asia	0.07%	0.07%	5.68%	19.04%	5.09%	10.60%
Shanghai Composite	-5.17%	9.04%	7.94%	13.35%	1.05%	3.36%
Hong Kong Hang Seng	-5.65%	-1.90%	-12.56%	-4.24%	-1.11%	4.00%
MSCI EMEA	0.24%	0.24%	-19.59%	-10.21%	-3.89%	1.69%
MSCI Latam	-0.57%	-0.57%	-36.30%	-27.54%	-11.73%	1.73%
GBI EM GD	0.20%	0.20%	-6.13%	-1.21%	0.43%	4.59%
ELMI+	0.21%	0.21%	-3.80%	-0.08%	0.03%	2.40%
EM FX Spot	0.19%	0.19%	-11.01%	-7.75%	-6.35%	-3.15%
EMBI GD	0.10%	0.10%	-0.41%	1.59%	3.51%	6.03%
EMBI GD IG	0.12%	0.12%	5.92%	7.19%	6.77%	7.08%
EMBI GD HY	0.07%	0.07%	-7.73%	-4.98%	-0.19%	4.75%
CEMBI BD	0.09%	0.09%	2.67%	4.82%	4.75%	6.25%
CEMBI BD IG	0.04%	0.04%	4.65%	5.53%	5.54%	5.67%
CEMBI BD Non-IG	0.14%	0.14%	-0.11%	3.74%	3.68%	7.29%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	-0.42%	-0.42%	5.12%	18.18%	11.96%	13.65%
1-3yr UST	-0.03%	-0.03%	3.09%	3.34%	2.65%	1.78%
3-5yr UST	-0.05%	-0.05%	6.17%	5.74%	4.09%	2.75%
7-10yr UST	-0.14%	-0.14%	11.29%	9.19%	6.73%	4.35%
10yr+ UST	-0.47%	-0.47%	20.77%	14.98%	11.72%	7.88%
10yr+ Germany	0.08%	0.08%	7.44%	0.86%	7.81%	5.26%
10yr+ Japan	-0.01%	-0.01%	-1.87%	-2.52%	1.89%	2.99%
US HY	0.16%	0.16%	0.78%	3.91%	4.25%	6.94%
European HY	0.35%	0.35%	-3.07%	-0.82%	1.33%	3.96%
Barclays Ag	0.02%	0.02%	5.74%	6.05%	4.19%	3.77%
VIX Index*	4.78%	4.78%	100.51%	62.15%	200.65%	41.40%
DXY Index*	-0.12%	-0.12%	-2.71%	-5.09%	-0.20%	-2.42%
CRY Index*	-2.95%	-2.95%	-22.43%	-16.93%	-21.22%	-26.61%
EURUSD	0.04%	0.04%	4.43%	6.77%	0.15%	4.83%
USDJPY	-0.05%	-0.05%	2.84%	1.47%	6.80%	14.09%
Brent	-2.00%	-2.00%	-39.20%	-31.25%	-29.60%	-18.52%
Gold spot	-0.30%	-0.30%	24.25%	26.16%	48.70%	66.75%

*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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