Issued: 8 March 2021

Ashmore

Transitions

By Jan Dehn and Gustavo Medeiros

Transitions are noisy, but interesting from an investment perspective. The latest trends from purchasing managers' surveys. New policy directions from China. Colombia's 2021 financial plan. A prudent approach to fiscal stimulus in Brazil. A policy set back in Mexico. Brighter prospects for reform in El Salvador. South Korea solid economic activity.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	13.7	–	0.06%
MSCI EM Small Cap	10.4	–	0.18%
MSCI Frontier	9.8	–	-0.65%
MSCI Asia	15.0	–	-0.24%
Shanghai Composite	11.6	–	-0.20%
Hong Kong Hang Seng	9.4	–	0.40%
MSCI EMEA	9.8	–	1.33%
MSCI Latam	10.8	–	2.34%
GBI-EM-GD	4.81%	–	-1.79%
ELMI+	2.88%	–	-0.92%
EM FX spot	–	–	-1.30%
EMBI GD	5.22%	358 bps	-0.82%
EMBI GD IG	3.39%	169 bps	-0.89%
EMBI GD HY	7.56%	598 bps	-0.74%
CEMBI BD	4.37%	301 bps	-0.31%
CEMBI BD IG	3.11%	176 bps	-0.32%
CEMBI BD Non-IG	6.05%	468 bps	-0.28%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	19.4	–	0.84%
1-3yr UST	0.14%	–	-0.04%
3-5yr UST	0.82%	–	-0.23%
7-10yr UST	1.59%	–	-1.18%
10yr+ UST	2.31%	–	-2.86%
10yr+ Germany	-0.30%	–	-0.10%
10yr+ Japan	0.00%	–	1.52%
US HY	4.34%	329 bps	-0.16%
European HY	3.27%	380 bps	0.14%
Barclays Ag	1.11%	-48 bps	-1.01%
VIX Index*	24.66	–	-3.29%
DXY Index*	92.05	–	1.01%
EURUSD	1.1889	–	-1.33%
USDJPY	108.43	–	1.56%
CRY Index*	193.45	–	3.01%
Brent	70.6	–	10.88%
Gold spot	1704	–	-1.19%

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

Emerging Markets

- **Transitions:** Transitions from expansion to contraction and vice versa are typically associated with temporary bouts of elevated uncertainty. Uncertainty increases during transitions not only because the pace of economic growth changes, but also because policies typically shift significantly in response to big shifts in growth. In addition, markets participants have a habit of extrapolating from purely transitory phenomena into the far distant future, such that market moves around transitions can be characterised by considerable over- or under-shooting. Last year was a classic case in point. Global markets began to gyrate in February, culminating with major collapses in stock and credit markets in late March as Western economies transitioned from relatively normal business cycle dynamics to fully-fledged pandemic economies and policy-makers embarked on massive programmes of monetary and fiscal stimuli. Inevitably, markets reacted extremely violently to the unfolding events with most investors selling Emerging Markets (EM) assets at the time, since many still deem EM assets to be far more 'risky' than Developed Market (DM) assets. Hence, like in every previous risk-off episode, EM assets dropped so sharply that prices inevitably overshot to the downside; the absolutely best entry point last year was at the very height of the market panic on 23 March, because EM assets staged very strong recoveries for the rest of the year after that date.

Markets are now once again going through an important transition, albeit this time the other way around, that is, from bad to good. The outlook for growth is improving and markets are adjusting the cost of money to reflect stronger economies and higher risks of inflation. The moves in term rates in the US Treasury market have been so rapid that they have already triggered some nervousness among investors. This is unsurprising in light of the experiences from previous transitions. Indeed, it is quite likely that this transition too will see its fair share of over-extended extrapolations and excessive price volatility until a sense of normality has finally been restored. Fortunately, so far the fallout from the transition has been relatively contained, albeit with some of the usual 'sell EM mentality' on display, particularly in local currency bond markets.

Continued overleaf

Emerging Markets

Tallying up the score year to date, EM equities have done relatively well so far, up 3.8% compared to 2.6% for the US stock market. EM Dollar-denominated bonds have also held their own against US government bonds with a return of -4.4% compared to -4.5% for the US 10-year Treasury bond. Within EM external debt, investment grade rated bonds are down 5.5% on account of their longer duration and tighter spread over US Treasuries, but EM high yield sovereign bonds, which have fat spread cushions have outperformed (-3.1% ytd). As is often the case, EM local bonds have taken a bigger hit, down 5.4% for the year so far, with 3.2% of this drop is accounted for by currencies amidst a broad resurgence of the Dollar (DXY is up 2.4% ytd). EM corporate high yield bonds (+0.6%) have so far outperformed US high yield bonds (+0.5%). The biggest difference between this year's transition from collapse to expansion and last year's transition from normality to collapse is what is happening to commodity prices. Whereas last year oil prices collapsed and briefly traded with negative prices, so far this year oil prices (Brent crude) are up 36.3%. This is helping the small but important segment of EM that is highly specialised in producing oil.

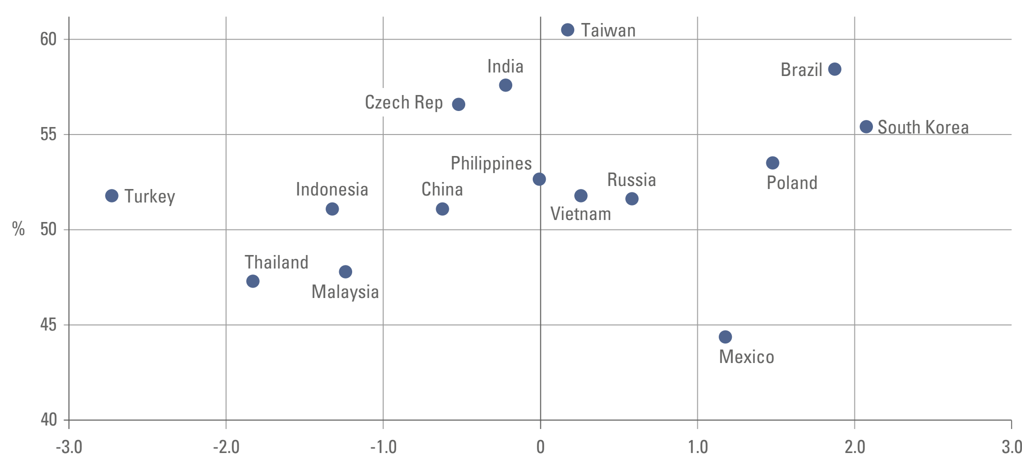
Similar to the 2020 transition, we expect the outbreak of uncertainty associated with the 2021 transition to be strictly transitory. Unlike the 2020 transition, however, we expect the 2021 transition to give way to sustained outperformance of EM assets due to a combination of factors that include far more favourable technicals versus developed markets (DMs), superior growth, and better valuations. We are particularly bullish about prospects for local currency denominated assets, because we do not see the basis for anything other than a very brief Dollar rally at these valuations. Investors should therefore exploit any temporary pullback associated with the ongoing transition to normality to add to positions in EM, particularly in local markets. For further details please see Ashmore's 2021 outlook publications.[1]

- The latest in development in global manufacturing and services: The global manufacturing purchasing managers index (PMI) rose to 55.0 in February from 54.2 in January. A reading above 50 signifies economic expansion. Emerging Markets (EM) aggregate manufacturing PMI moderated to 51.5 in February from 52.1 in January, while the EM services PMI rose to 51.7 from 51.6 over the same period. DMs outperformed with manufacturing PMI rising to 56.4 in February from 55.2 in January and the DM services PMI up 0.8 points to 53.2.

Breaking down the broad PMIs by component, most of the rise in the DM PMIs could be attributed to higher input prices rather than higher activity levels. Input prices rose by 5.2 points to 69.2, partly due to slower delivery time by suppliers (dropped 3.7 points to 32.0). On the positive side, the DM manufacturing employment index rose 1.5 points to 52.6. In EM, the future output index – a forward-looking component of the overall index – rose the most (+3.1) to 64.6 with input prices unchanged at 60.7. On the other hand, the EM new orders index declined 1.3 to 51.6, while new export orders were flat at 48.

Breaking down PMIs by country, manufacturing PMIs were above 55 in February in Taiwan, Brazil, India, Czech Republic, and South Korea (Figure 1). All EM countries were in expansionary territory, except for Myanmar, Mexico, Malaysia, and Thailand. Most of the downside from EM manufacturing PMI was concentrated in Myanmar (-20.1 to 27.7)* and Turkey (-2.7) to 51.7, while most upside came from South Korea (+2.1 to 55.3) and Brazil (+1.9 to 58.4).

Fig 1: **EM Manufacturing PMIs: Last vs. 1 month change**



Source: Markit PMI, Bloomberg, Ashmore as at February 2021. *Myanmar is not in the chart

[1] See '*The 2021 Outlook: Seven themes for a post-vaccine world*', The Emerging View, 17 December 2020, and '*Equity Outlook 2021: Emerging Markets*', The Emerging View, 6 January 2021.

Emerging Markets

- **China:** A draft version of the National People's Congress (NPC) 14th five-year work report de-emphasised the annual GDP growth target. The 2021 real GDP growth target will still be above 6.0%, but this is lower than the median consensus growth expectation of 8.4% on Bloomberg. The report also proposes a faster than expected pace of local government special bonds issuance with a focus on financing infrastructure investment (RMB 3.65tn). China aims to increase the urbanisation ratio to 65% by 2025 from 60.6% in 2019, maintain an annual rate of growth of reserach and development spending of 7% and cut carbon emissions to 18% of GDP by 2025. In other news, Chinese exports grew at a yoy rate of 60.6% in the first two months of 2021 compared to 18.1% yoy in December. The fast pace of exports was partly due to a very low base and an earlier than usual return of business following the Chinese New Year. Imports were up 22.2% yoy in January and February from 6.5% yoy in December, partly due to base effects and higher commodity prices. China's average trade surplus for the first two months of the year narrowed to USD 51.6bn from USD 78.2bn in December. Customs data shows imports of computer chips rising 59.2% in yoy terms in the first two months of the year, while coal imports declined at a yoy pace of 39.5%.

- **Colombia:** The government updated its 2021 fiscal target. The new projections consider real GDP growth to rebound 5.0% in 2021 after the 6.8% contraction in 2020 while the fiscal deficit will widen to 8.6% of GDP from 7.9% of GDP over the same period. The budget assumes that Brent oil price will average USD 53 per barrel in 2021. The deficit is wider than the market originally expected as some healthcare and economic reactivation expenses were postponed to 2021 from 2020. The government committed to adjust the fiscal deficit from 2022 via a revenue-enhancing fiscal reform which should allow the debt to GDP ratio to decline from 65% currently to 60% by the end of 2030. The risk of rating agencies downgrading the country below investment grade after the budget, albeit higher oil prices may lead to a faster economic rebound and lower fiscal deficits than forecasted by the government. Colombia sovereign rating is currently rated BBB- by S&P and Fitch and Baa2 by Moody's. The yoy rate of CPI inflation was unchanged at 1.6% in February. The core CPI inflation rate was also unchanged at 0.9% yoy. The current account deficit widened to USD 3.1bn in Q4 2020 from USD 1.8bn deficit in Q3 2020.

- **Brazil:** The Senate approved an Emergency spending bill that allows for transfers of up to BRL 44bn (USD 7.9bn) to individuals to help cope with the ongoing coronavirus outbreak. The new spending bill respects the fiscal ceiling imposed under the previous government by allowing the government to reduce the number of working hours and salaries in the event earmarked spending exceeds 95% of total revenue. Also, various tax benefits will be reduced to 2% of GDP from 4% of GDP by 2026. In other news, the yoy rate of real GDP growth declined 1.1% in Q4 2020, which was an improvement from -3.9% yoy recorded in Q3 2020. The GDP print also surprised to the upside relative to consensus expectations. Industrial production rose at a pace of 2.0% yoy in January, which was a slowdown relative to the 8.2% yoy rate of growth witnessed in December. The trade balance surplus was USD 1.2bn in February following a USD 1.1bn deficit in January on the back of rising exports (+USD 2.2bn to 16.2bn) and declining imports (-USD 0.9bn to USD 15.0bn).

- **Mexico:** In a negative development, the Congress approved President Andres Manual Lopez Obrador's proposal to reform the electricity sector. The bill assigns greater priority to the state-owned company CFE in electricity generation, while limiting participation by international investors. The reform is negative for Mexico and will increase scepticism about Mexico's future prospects among foreign investor.

- **El Salvador:** President Nayib Bukele's *Nuevas Ideas* Party obtained a two-thirds majority in the mid-term parliamentary election, which should be sufficient to pass constitutional reforms. Finance Minister Alejandro Zelaya said the government will seek a USD 1.3bn loan from the IMF in order to kick-start the economy and cover the bulk of the governments funding needs of USD 2.0bn in 2021.

- **South Korea:** Stronger than expected economic data in South Korea. Exports rose at a yoy rate of 9.5% in February from 11.4% yoy in January, while imports rose 13.9% yoy compared to 3.6% yoy over the same period. The trade surplus therefore narrowed by USD 1.1tn to USD 2.7bn. The yoy rate of CPI inflation rose to 1.1% yoy in February from 0.6% yoy in January and IP expanded at a yoy rate of 7.5% in January compared to 2.5% yoy in December. Lastly, the yoy rate of real GDP growth declined 1.2% in Q4 2020 after declining 1.4% in Q3 2020.

Snippets:

- **Argentina:** Consumer prices index (CPI) inflation was 3.5% in February compared to 4.0% in January, according to high frequency data tracked by Eco-Go. Food CPI inflation was 4.6%. The trade surplus was USD 1.1bn in January compared to a deficit of USD 0.4bn in December, mainly due to higher export prices.
- **Chile:** The Lower House admitted a bill that would allow a third leg of 10% redemptions from the pension system, further undermining the country's long-term savings and increasing risks to financial stability.
- **Costa Rica:** The International Monetary Fund (IMF) approved a USD 1.8bn loan under the Extended Fund Facility (EFF) programme.
- **Ecuador:** The government agreed to set up a technical committee within the National Assembly to review the reform of the rules governing the central bank.

Continued overleaf

Emerging Markets

- Egypt: The Health Minister announced that Egypt has started to vaccinate the population against the Covid-19 coronavirus.
- Hong Kong: The yoy rate of retail sales declined 13.6% in January after contracting at a yoy rate of 13.3% in December.
- Hungary: Industrial production (IP) increased 0.2% in January after declining 2.7% in December. The yoy rate of real GDP growth declined 3.6% in Q4 2020 after contracting 3.7% in Q3 2020. Retail sales declined at a yoy rate of 1.8% in January after declining 4.0% yoy in December.
- India: The trade deficit narrowed to USD 12.9bn in February from USD 14.5bn in January.
- Indonesia: The yoy rate of CPI inflation slowed to 1.4% in February from 1.6% yoy in January, while the rate of core CPI inflation declined to 1.5% yoy from 1.6% yoy, both in line with the median Bloomberg survey.
- Kenya: Parliament approved a cap on the fiscal deficit for 2021-22 of 7.5% of GDP, which was lower than initial expectations.
- Malaysia: Bank Negara Malaysia kept its policy rate unchanged at 1.75% in line with consensus expectations.
- Nigeria: Foreign exchange (FX) reserves declined to USD 35bn in February from USD 36.5bn in January.
- Pakistan: The yoy rate of CPI inflation increased to 8.7% in February from 5.6% in January. This was slightly above the median survey of expectations published by Bloomberg. Exports declined 4.1% in yoy terms in February after rising 8.1% yoy in January, while the yoy pace of imports slowed to 9.6% from 14.9% over the same period.
- Philippines: The yoy rate of CPI inflation rose to 4.7% in February from 4.2% yoy in January, in line with consensus expectations. Bank lending declined at a yoy rate of 2.2% in January after declining 0.7% yoy in December.
- Poland: The Central Bank of Poland kept its policy rate unchanged at 0.1%, in line with consensus expectations.
- Sri Lanka: The Central Bank of Sri Lanka kept its lending and deposit policy rates unchanged at 5.5% and 4.5% respectively, in line with consensus expectations.
- Taiwan: The government said it has sufficient water to keep the giant semiconductor plant from Taiwan Semiconductor Manufacturing Co (TSMC) running until the end of May and from there monsoon rains should alleviate one of the worst drought in decades. Some industries like US automakers have already suffered with the shortage of chips.
- Thailand: The yoy rate of CPI inflation declined to -1.2% in February after contracting at a yoy rate of 0.2% in January. The surprise to the downside relative to consensus expectations was mostly due to water and electricity price controls imposed by the government. The yoy rate of core CPI inflation declined to 0.0% in February from 0.2% yoy in January.
- Turkey: The yoy rate of CPI inflation rose to 15.6% in February from 15.0% yoy in January, while core CPI inflation increased to 16.2% yoy from 15.5% yoy. Both prints were above consensus expectations. Real GDP growth was 5.9% on a yoy basis in Q4 2020 after an expansion of 6.3% yoy in Q3 2020.
- Uruguay: The yoy rate of CPI inflation was 9.1% in February compared to 8.9% yoy in January.

Global backdrop

- Commodity prices: Oil prices as measured by the Brent first future contract rose 10.9% in the course of the week to USD 70.6 per barrel this morning after the OPEC+ cartel announced it would keep production unchanged in April. Saudi Arabia pledged to maintain its voluntary production cut of one million barrels per day and other members agreed to keep production unchanged in April. Only Russia and Kazakhstan were granted exemptions.

- United States (US): The Senate voted 51-50 in favour of a USD 1.9tn fiscal stimulus proposed by President Joe Biden. The Lower House of Congress is expected to approve the same version of the bill early this week before handing the bill over to Biden for signature. Payments worth USD 1.4k per adult will be begin in March.[2] Parents will get an additional USD 1.4k per child. The latest estimate from the Congressional Budget Office (CBO) puts the 2021 fiscal deficit at USD 2.3bn, or 10.3% of GDP. This does not include the USD 1.9tn Biden package. The fiscal deficit is therefore likely to be the second largest since 1945 exceeded only by the 2020 fiscal deficit of 14.9% of GDP.[3] The CBO notes that the USD 0.9tn fiscal package approved in December last year only contributed USD 0.5tn to GDP, which a very poor fiscal multiplier. The fiscal multiplier in the newly approved Biden package may be even worse assuming the diminishing return nature of fiscal stimulus which are destined to sponsor consumption and does not contribute to increase the overall level of productivity.

[2] This applies to individuals with less than USD 75k in annual income and households making less than USD 112.5k per annum. Couples with less than USD 150k income will receive USD 2.8k. Individuals making between USD 75k and USD 80k and couples making between 150k and 160k will receive reduced payments.

[3] See: https://www.cbo.gov/publication/57043#_idTextAnchor001

Continued overleaf

Benchmark performance

In economic news, labour market data in February surprised to the upside as non-farm payrolls grew by 379k compared to 166k in January. Private payrolls recovered to 465k from 0k over the same period. The ISM manufacturing survey rose to 60.9 in February from 58.7 in January, while the Markit's manufacturing PMI rose more modestly to 58.6 from 58.5 over the same period. On the other hand, the ISM services index declined to 55.3 from 58.7, while ISM prices paid rose to 86 in February from 80 in January. This is the highest level since 2008. Since 2006, every time that ISM prices paid has risen above 80, the yoy rate of headline CPI inflation has in turn risen above 3% with a 2-months lag as shown in Figures 2 and 3. Meanwhile, the US trade deficit widened to USD 68.2bn in January from 67.0bn in December. Construction spending and factory orders rose 1.7% and 2.6% in January, respectively.

Fig 2: **ISM prices paid 2 month lagged vs CPI**

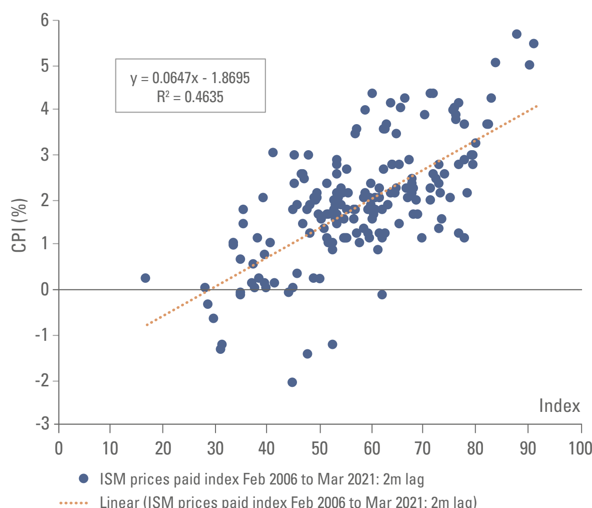


Fig 3: **Prices paid vs CPI yoy**

Source: Bloomberg, Ashmore. Data as at 5 March 2021.

Despite the near-term inflationary risks and the large fiscal stimulus now underway, the Chairman of the Federal Reserve Jerome Powell said that monetary policy would remain loose. When asked about the sharp increase in term yields in the US Treasury market, Powell said that he "would be concerned by disorderly conditions in markets or persistent tightening in financial conditions". Financial conditions remain very loose as long-term mortgage rates are still close to their lowest levels in history. Investment grade bond spreads also remain tight and equity markets are still trading close to their all-time highs.

- **European Union (EU):** Euro area yoy CPI inflation was unchanged at 0.9% in February, while the rate of core CPI inflation declined to 1.1% from 1.4% in January. German retail sales declined 4.5% in January following a 9.1% contraction in December.

Continued overleaf

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	0.06%	3.84%	3.84%	32.06%	7.30%	14.15%
MSCI EM Small Cap	0.18%	6.24%	6.24%	39.38%	5.12%	10.53%
MSCI Frontier	-0.65%	-0.14%	-0.14%	9.56%	-1.03%	6.64%
MSCI Asia	-0.24%	5.03%	5.03%	36.67%	10.27%	15.79%
Shanghai Composite	-0.20%	0.83%	0.83%	16.69%	4.92%	6.39%
Hong Kong Hang Seng	0.40%	5.16%	5.16%	9.43%	1.89%	9.95%
MSCI EMEA	1.33%	4.41%	4.41%	13.77%	-2.56%	6.77%
MSCI Latam	2.34%	-7.37%	-7.37%	-2.09%	-6.94%	5.20%
GBI EM GD	-1.79%	-5.44%	-5.44%	-0.27%	-0.02%	4.44%
ELMI+	-0.92%	-2.08%	-2.08%	2.19%	-0.18%	2.84%
EM FX Spot	-1.30%	-3.19%	-3.19%	-3.03%	-6.19%	-2.55%
EMBI GD	-0.82%	-4.40%	-4.40%	-1.54%	4.25%	5.52%
EMBI GD IG	-0.89%	-5.55%	-5.55%	-1.93%	6.35%	5.71%
EMBI GD HY	-0.74%	-3.06%	-3.06%	-1.39%	1.91%	5.25%
CEMBI BD	-0.31%	-0.47%	-0.47%	4.07%	6.18%	6.65%
CEMBI BD IG	-0.32%	-1.29%	-1.29%	2.51%	6.34%	5.65%
CEMBI BD Non-IG	-0.28%	0.63%	0.63%	6.13%	5.96%	8.23%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	0.84%	2.56%	2.56%	29.28%	14.32%	16.18%
1-3yr UST	-0.04%	-0.07%	-0.07%	1.05%	2.85%	1.78%
3-5yr UST	-0.23%	-1.08%	-1.08%	0.91%	4.31%	2.46%
7-10yr UST	-1.18%	-4.54%	-4.54%	-2.93%	5.85%	2.82%
10yr+ UST	-2.86%	-11.58%	-11.58%	-10.40%	7.83%	3.88%
10yr+ Germany	-0.10%	-5.78%	-5.78%	-6.49%	6.30%	3.33%
10yr+ Japan	1.52%	-0.77%	-0.77%	-3.70%	1.06%	0.79%
US HY	-0.16%	0.54%	0.54%	8.26%	6.63%	8.37%
European HY	0.14%	1.37%	1.37%	5.15%	3.46%	5.09%
Barclays Ag	-1.01%	-3.58%	-3.58%	1.93%	3.34%	3.36%
VIX Index*	-11.77%	8.40%	8.40%	-41.20%	49.09%	32.08%
DXY Index*	1.29%	2.35%	2.35%	-4.07%	2.07%	-5.31%
CRY Index*	1.58%	15.29%	15.29%	24.13%	-0.11%	14.15%
EURUSD	-1.54%	-2.68%	-2.68%	3.86%	-3.44%	8.01%
USDJPY	1.75%	5.02%	5.02%	5.92%	2.07%	-3.72%
Brent	6.79%	36.33%	36.33%	56.00%	11.02%	78.11%
Gold spot	-1.71%	-10.21%	-10.21%	1.43%	28.93%	35.12%

*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.

Continued overleaf

Ashmore

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

Dublin
T: +353 1588 1300

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
T: +81 03 6860 3777

Other locations

Lima

Shanghai

Bloomberg page
Ashmore <GO>

Fund prices
www.ashmoregroup.com
Bloomberg
FT.com
Reuters
S&P
Lipper

No part of this article may be reproduced in any form, or referred to in any other publication, without the written permission of Ashmore Investment Management Limited © 2021.

Important information: This document is issued by Ashmore Investment Management Limited (Ashmore), which is authorised and regulated by the Financial Conduct Authority. The information and any opinions contained in this document have been compiled in good faith, but no representation or warranty, express or implied, is made as to accuracy, completeness or correctness. Save to the extent (if any) that exclusion of liability is prohibited by any applicable law or regulation, Ashmore, its officers, employees, representatives and agents expressly advise that they shall not be liable in any respect whatsoever for any loss or damage, whether direct, indirect, consequential or otherwise however arising (whether in negligence or otherwise) out of or in connection with the contents of or any omissions from this document. Past performance is not a reliable indicator of future results. This document does not constitute and may not be relied upon as constituting any form of investment advice and prospective investors are advised to ensure that they obtain appropriate independent professional advice before making any investment.