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WEEKLY INVESTOR RESEARCH

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EM outperformance on stronger economic recovery

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Upside surprises in economic activity across Emerging Markets (EM) feeds strong performance in markets. Brazil signalled the end of fiscal transfers by year-end. China had another month of robust credit expansion. Romania moved towards forming a new government led by a market-friendly centre-right coalition. South Africa had the best current account data in more than a decade. Remittances were stronger than expected in Egypt. Indian high frequency economic data surprised to the upside again in December. Mexican inflation declined more than expected, opening the door for further rate cuts in 2021. In Ghana, the market-friendly incumbent President Akufo-Addo was re-elected for another four years. Malaysia's government approved a new pension withdrawal scheme.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	14.8	–	0.54%
MSCI EM Small Cap	13.7	–	0.89%
MSCI Frontier	11.7	–	0.71%
MSCI Asia	15.8	–	0.21%
Shanghai Composite	13.0	–	-2.82%
Hong Kong Hang Seng	9.3	–	-1.62%
MSCI EMEA	11.1	–	1.50%
MSCI Latam	13.4	–	1.86%
GBI-EM-GD	4.31%	–	0.63%
ELMI+	1.51%	–	0.03%
EM FX spot	–	–	0.33%
EMBI GD	4.66%	370 bps	0.16%
EMBI GD IG	2.77%	176 bps	0.11%
EMBI GD HY	7.14%	622 bps	0.23%
CEMBI BD	4.08%	336 bps	0.53%
CEMBI BD IG	2.80%	208 bps	0.41%
CEMBI BD Non-IG	5.91%	518 bps	0.70%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	21.3	–	-0.95%
1-3yr UST	0.12%	–	0.07%
3-5yr UST	0.37%	–	0.22%
7-10yr UST	0.91%	–	0.64%
10yr+ UST	1.65%	–	1.97%
10yr+ Germany	-0.64%	–	2.00%
10yr+ Japan	0.00%	–	0.36%
US HY	4.44%	384 bps	0.18%
European HY	3.44%	413 bps	-0.02%
Barclays Ag	0.84%	-7 bps	0.35%
VIX Index*	23.31	–	2.52%
DXY Index*	90.73	–	-0.06%
EURUSD	1.2142	–	0.27%
USDJPY	104.00	–	-0.05%
CRY Index*	161.25	–	1.35%
Brent	50.4	–	3.30%
Gold spot	1833	–	-1.59%

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

Emerging Markets

Economic data surprised to the upside in Brazil, China, South Africa, Egypt, India, and Mexico. Better than expected growth in Q4 2020 lays the foundation for a strong rebound in 2021, when several vaccines against coronavirus should allow for the full normalisation of economic activity. The stronger than expected economic data is starting to be reflected in EM asset returns. The MSCI EM, a widely used EM stock market index, is up 4.3% in the first two weeks of December compared with 1.2% for the S&P 500 and 1.5% for the MSCI World. EM currencies are up 2.0% over the same period, outperforming the broad Dollar, which is down 1.0%. EM fixed income is also outperforming on a month-to-date basis with EM local currency bonds up 2.5%, high yield (HY) sovereign and corporate bonds up 2.0% and 1.5%, respectively, while investment grade (IG) indices in sovereign and corporate debt have returned 0.1% and 0.5%, respectively. Over the same period, US HY is up 1.0% and 10-year US Treasuries are down 0.3%.

- **Brazil:** There was good news for the prospect of fiscal consolidation in 2021 after President Jair Bolsonaro said his government would not seek to renew income transfers designed to alleviate the impact of the coronavirus shock. Meanwhile, economic activity continued to recover as services output rose 1.7% in October following growth of 2.1% in September, which was a positive surprise relative to consensus expectations. The yoy rate of consumer prices index (CPI) inflation rose to 4.3% in November from 3.9% yoy in October, while core CPI rose to 2.7% yoy from 2.4% yoy over the same period. Against this backdrop, the Brazilian Central Bank (BCB) kept the Selic policy rate unchanged at 2.0%, but signalled potential rate hikes next year contingent on the evolution of inflation expectations. BCB also offered Dollars to the market via FX swaps to allow banks to unwind derivative positions without impacting BRL.

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Emerging Markets

- China: Credit data surprised to the upside as total social financing rose RMB 2.1tn in November from RMB 1.4tn in October, mostly due to an increase in new loans to the real economy. Economic momentum remained solid as auto sales rose by 8% on a yoy basis in November and sales by the top-100 property developers rose by 21% yoy over the same period. Xinhau, a news outlet, reiterated government warnings that houses are for living, not for speculation. This illustrates government concerns about potential overheating in the property sector and could imply that the government will start to reduce credit availability as the economy moves on from the pandemic. Currently, the general economy shows no signs of overheating with the yoy rate of CPI inflation declining to -0.5% in November from 0.5% in October, which was a downside surprise relative to consensus expectations. The yoy rate of core CPI inflation was unchanged at 0.5%, while the rate of PPI inflation increased to -1.5% yoy in November from -2.1% yoy in October. In corporate news, the chipmaker Tsingua Unigroup defaulted on a USD 450m bond, which can lead creditors to accelerate on a total of USD 2bn of bonds. China has, for some time, been allowing the private sector to determine the cost of funding for companies, and allowing bad debtors to default. The greater reliance on markets in resource allocation is the foundation for a more stable and sustainable debt capital market as well as a more productive economy. In environmental news, President Xi Jinping announced that China will increase the non-fossil fuel share of energy use to 25% by 2030.

- Romania: The Romanian President Klauss Iohanis met with Florin Citu, the leader from the PNL party, who has been put forward to be the country's new Prime Minister. The leaders of the four parties of Romania centre-right coalition agreed to work towards forming a new government, when parliament convenes in the week starting 21 December. An eventual confirmation of Citu as Prime Minister would be good news for fiscal stability in Romania. Citu was Finance Minister in the previous liberal government and would focus on reducing the country's fiscal deficit in 2021.

- South Africa: The current account surplus reached the equivalent of 5.9% of GDP in Q3 2020, which is the strongest result in ten years, supported by higher exports of gold, platinum, and other metals. The real rate of GDP growth was a whopping 66.1% in Q3 2020, although higher frequency data has disappointed somewhat since with mining production declining at a yoy rate of -6.3% in October (versus -3.4% in September) and manufacturing down 3.4% on a yoy basis in October (from -1.9% yoy in September). In other news, the yoy rate of CPI inflation declined to 3.2% in November from 3.3% in October.

- Egypt: Remittances were 19% higher on a yoy basis in Q3 2020, reaching USD 8bn. The yoy rate of CPI inflation rose to 5.7% in November from 4.5% in October, mostly due to unfavourable base effects from very low inflation rates in 2019. Planning Minister Hala El-Saeed said that Egypt is preparing to privatise companies owned by the military, including a mineral water producer and an oil company. This is part of a broader initiative to reduce the influence of the military in the economy. A smaller role of the military in the economy would be good news. It would reduce corruption and increase productivity as well as stimulate greater foreign direct investment in the economy.

- India: The yoy rate of industrial production reached 3.6% in October versus the more modest consensus expectation for a 0.6% yoy increase. Electricity demand increased at a yoy rate of 7.0% in the first week of December from a 3.5% yoy in November. Economic activity seems to be recovering after the economic lull during the Diwali festival in mid-November. The yoy rate of wholesale prices inflation was 1.55% in November versus 1.70% yoy expected.

- Mexico: Industrial production rose 2.0% in October, surprising consensus expectations to the upside. Construction activity rebounded strongly. The yoy rate of CPI inflation declined to 3.3% in November from 4.1% yoy in October, while core CPI inflation was down to 3.7% yoy. Both headline and core inflation surprised to the downside. Inflation is now within Banxico's target band of 3.0% to 4.0%, which may bring Banco de Mexico (Banxico) to lower policy rates. Last week, Galia Borja was nominated to replace Javier Guzman as member of Banxico's monetary policy committee.

- Ghana: Incumbent President Nana Akufo-Addo won a second term in the general election conducted at the weekend. Akufo-Addo received 51.3% of the votes cast against 47.3% in support of opposition candidate John Mahama. The opposition said it will contest the election result without presenting evidence of wrongdoing. Parliament is split with a single independent politician holding the balance of power as Akufo-Addo's party won 137 seats versus 136 seats for the opposition.

- Malaysia: In negative news for long-term financial stability, the government announced a new pension withdrawal scheme, which could lead to MYR 70bn redemptions from the pension system, according to government estimates. A few other EM countries, including Chile and Peru, are also withdrawing funds from pension schemes in order to support private sector demand during the pandemic. While pension fund withdrawals ease governments' immediate fiscal burdens, they undermine the pension system, which forms the backbone of the financial system. In other news, the yoy rate of industrial production declined 0.5% in October from 1.0% yoy in September, while manufacturing sales rose 2.2% on a yoy basis from 3.7% yoy over the same period.

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Emerging Markets

Snippets:

- Chile: The Central Bank of Chile kept the policy rate unchanged at 0.5% in line with consensus expectations. The yoy rate of CPI inflation declined to 2.7% in November from 3.0% in October.
- Colombia: The yoy rate of CPI inflation declined to 1.5% in November from 1.8% yoy in October.
- Gabon: Moody's lowered the outlook to stable from positive on Gabon's Caa1 sovereign credit rating despite the government's impeccable debt service record and the recent announcement of a plan to clear the payment arrears, which had been the original reason for an earlier decision by Moody's to downgrade the credit to below the B- level.
- Ivory Coast: The Executive Board of the International Monetary Fund (IMF) ratified the 7th and 8th reviews of the country's Extended Fund Facility (EFF) programme. This should pave the way for disbursement of the final USD 278m of the USD 1.2bn programme.
- Namibia: Moody's downgraded Namibia's sovereign credit rating to Baa3 with a negative outlook citing a combination of sluggish growth, a large public sector wage bill, and high borrowing requirements.
- Nigeria: The World Bank said further reforms of Nigeria's FX system are needed before the country can secure a USD 1.5bn loan.
- Qatar: The Emir of Qatar is likely to attend the 41st Gulf Cooperation Council (GCC) summit to be held in Riyadh, Saudi Arabia, on the 5th January 2021. This is a sign of the improving relations between Qatar and the other Persian Gulf economies, including Saudi Arabia.
- Philippines: The trade deficit was unchanged at USD 1.8bn in October, which was slightly better than consensus expectations.
- Sri Lanka: Rating agency S&P downgraded Sri Lanka's sovereign credit rating to CCC+ from B-. The downgrade follows recent downgrades from Moody's and Fitch.
- Turkey: The United States (US) government is reportedly contemplating sanctions on Turkey for buying Russian military equipment. Turkey, a member of the NATO alliance, has been at loggerheads with US and the European Union (EU) over various issues during President Recep Tayyip Erdogan's period in office. For the time being, the sanctions are expected only to target individuals and therefore not to have a significant impact on the economy.

Global backdrop

- Coronavirus: The US Food and Drug Administration (FDA) approved a vaccine from Pfizer for emergency use, clearing the way for the vaccine to be distributed in the US. New cases, hospitalisations, and fatalities reached new highs, prompting several states to tighten mobility restrictions. Germany also imposed further lockdown measures in a bid to contain the virus. In a highly populist move, UK eased restrictions leading up to Christmas, but case numbers are already rising again as a result.

- US: In a swingeing blow to President Donald Trump's hopes to litigate his way to staying on in the White House after clearly losing the presidential election on 3 November, the Supreme Court rejected a lawsuit brought by the swing state of Texas. Republican Senate Leader Mitch McConnell rejected the fiscal package proposed by the Lower House as the Republicans oppose Federal aid to states and other local governments. Both Airbnb and DoorDash saw their share price double in their respective initial public offerings despite moves by the Federal Trade Commission and a coalition of US states to sue Facebook for breaking antitrust laws. The suit could lead to the breakup of the social media hegemon, which also controls Whatsapp. In economic news, high frequency data continues to point to a slowdown in the US economy as the increase in the incidence of coronavirus reduces mobility. Jobless claims rose to 853k in the week ending on 5 December from 716k in the previous week, while continuing claims rose by 300k to 5.8m people for the week ending on 28 November. On the other hand, housing data remained strong with mortgage applications rising to their highest level since 2009. The University of Michigan sentiment survey rose to 81.4 in December from 76.9 in November as news of a vaccine against coronavirus boosted sentiment. The yoy rate of CPI inflation rose to 1.2% in November, while the rate of core CPI inflation was 1.6% in November with increases in the prices of energy, apparel, and electronic appliances.

- EU: The EU approved a EUR 1.8trn finance package after Poland and Hungary agreed on adherence to rule of law provisions. This is the first time the EU has linked funding and rule of law. It sends a strong signal to Hungary and Poland to uphold key European values, such as freedom of the press and independent judiciaries. Meanwhile, the European Central Bank (ECB) increased asset purchases under its Pandemic Emergency Purchase Programme (PEPP). ECB will buy EUR 500bn more, thus bringing total purchases to EUR 1.85trn, while the programme will also be extended to the end of March 2022. ECB still has EUR 600bn available from

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Global backdrop

the existing PEPP. ECB President Christine Lagarde did not firmly establish a monthly purchase amount, saying that ECB may buy fewer bonds if conditions are benign, while also signalling that the programme could be increased if necessary. Prior to ECB's announcement, Spain has successfully issued a 10-year bond at negative nominal interest rates for the first time in history. The German ZEW survey of economic activity rose 16% on the expectation of economic normalisation due to vaccine developments in spite of the fact that the assessment of current activity remains at the most depressed level since 2009.

- **Brexit:** The President of the European Commission Ursula von der Leyen agreed to continue to negotiate with the United Kingdom (UK) over a trade deal in connection with Brexit. UK's Brexit transition period expires on 31 December 2020.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	4.38%	16.41%	15.33%	21.84%	6.81%	13.24%
MSCI EM Small Cap	4.07%	18.10%	15.48%	21.74%	3.59%	8.75%
MSCI Frontier	2.71%	8.06%	-1.28%	1.76%	-0.15%	5.90%
MSCI Asia	3.56%	15.02%	21.50%	28.01%	8.23%	13.78%
Shanghai Composite	-1.30%	4.06%	12.32%	17.15%	2.67%	1.75%
Hong Kong Hang Seng	-0.88%	11.27%	-2.71%	3.47%	0.89%	6.47%
MSCI EMEA	5.23%	15.06%	-7.70%	-2.00%	-0.56%	7.93%
MSCI Latam	9.82%	32.33%	-15.22%	-10.56%	-0.72%	8.60%
GBI EM GD	2.49%	8.57%	1.71%	4.35%	3.39%	6.78%
ELMI+	1.50%	5.37%	1.16%	2.75%	1.35%	3.52%
EM FX Spot	1.98%	6.45%	-5.44%	-3.52%	-4.17%	-1.50%
EMBI GD	0.96%	4.83%	4.29%	5.57%	4.90%	6.90%
EMBI GD IG	0.09%	2.25%	8.17%	8.49%	7.23%	7.55%
EMBI GD HY	2.01%	8.02%	-0.40%	1.92%	2.23%	6.08%
CEMBI BD	0.88%	3.83%	6.52%	7.34%	5.87%	6.98%
CEMBI BD IG	0.48%	2.37%	7.09%	7.47%	6.25%	6.14%
CEMBI BD Non-IG	1.45%	5.91%	5.64%	7.07%	5.35%	8.38%

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	1.21%	9.30%	15.39%	18.77%	13.41%	14.98%
1-3yr UST	0.04%	0.04%	3.15%	3.34%	2.77%	1.87%
3-5yr UST	0.04%	-0.11%	6.10%	6.17%	4.25%	2.87%
7-10yr UST	-0.24%	-1.27%	10.03%	9.21%	6.36%	4.27%
10yr+ UST	-0.92%	-2.75%	18.01%	14.92%	10.17%	7.37%
10yr+ Germany	1.25%	2.27%	9.79%	7.23%	7.68%	5.97%
10yr+ Japan	0.44%	0.36%	-1.50%	-1.07%	1.76%	2.94%
US HY	0.97%	5.50%	6.15%	7.54%	5.97%	8.40%
European HY	0.61%	5.27%	1.68%	2.38%	2.81%	4.60%
Barclays Ag	0.65%	2.58%	8.45%	8.79%	4.83%	4.48%
VIX Index*	13.32%	-11.60%	69.16%	84.56%	122.21%	2.55%
DXY Index*	-1.24%	-3.36%	-5.87%	-6.63%	-2.95%	-7.04%
CRY Index*	0.75%	8.58%	-13.21%	-12.27%	-12.47%	-7.47%
EURUSD	1.80%	3.59%	8.28%	8.96%	3.09%	10.46%
USDJPY	-0.30%	-1.40%	-4.24%	-5.07%	-7.47%	-14.06%
Brent	5.90%	23.08%	-23.64%	-22.72%	-20.39%	32.91%
Gold spot	3.17%	-2.79%	20.82%	24.18%	46.31%	72.97%

*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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