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Ashmore

EM status update

By Gustavo Medeiros and Jan Dehn

Vaccine developments, big improvements in economic activity, and more benign geopolitics bode very well for returns across EM markets in 2021, notably for EM equities. Turkey's central bank signals a welcome change in monetary policy, but is President Erdogan really on board? Peru may become more stable as Sagasti takes over the presidency. Thailand acts to stem currency appreciation. Bank Indonesia cuts the policy rate amidst strong external balances. China signals further trade liberalisation.

Emerging Markets	Next year forward PE/Yield	Spread over UST	P&L (5 business days)
MSCI EM	14.3	–	1.76%
MSCI EM Small Cap	12.8	–	3.03%
MSCI Frontier	12.1	–	0.79%
MSCI Asia	15.3	–	1.83%
Shanghai Composite	13.1	–	2.04%
Hong Kong Hang Seng	8.8	–	0.08%
MSCI EMEA	10.8	–	1.32%
MSCI Latam	12.7	–	3.93%
GBI-EM-GD	4.34%	–	1.16%
ELMI+	1.78%	–	0.80%
EM FX spot	–	–	0.94%
EMBI GD	4.76%	386 bps	0.46%
EMBI GD IG	2.74%	179 bps	0.40%
EMBI GD HY	7.50%	665 bps	0.54%
CEMBI BD	4.28%	358 bps	0.58%
CEMBI BD IG	2.86%	217 bps	0.44%
CEMBI BD Non-IG	6.29%	559 bps	0.78%

Global Backdrop	Next year forward PE/Yield/Price	Spread over UST	P&L (5 business days)
S&P 500	20.9	–	-0.73%
1-3yr UST	0.16%	–	0.04%
3-5yr UST	0.37%	–	0.10%
7-10yr UST	0.83%	–	0.41%
10yr+ UST	1.52%	–	1.96%
10yr+ Germany	-0.58%	–	0.83%
10yr+ Japan	0.00%	–	0.44%
US HY	4.84%	422 bps	0.61%
European HY	3.76%	445 bps	0.70%
Barclays Ag	0.87%	4 bps	0.71%
VIX Index*	23.70	–	0.60%
DXY Index*	92.39	–	-0.36%
EURUSD	1.1857	–	0.19%
USDJPY	103.86	–	-0.74%
CRY Index*	156.16	–	4.31%
Brent	45.0	–	5.10%
Gold spot	1871	–	-0.96%

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

Emerging Markets

At first sight, there are plenty of reasons to worry about the future. A second wave of the coronavirus pandemic is in full swing in Europe and the United States (US) with accompanying re-imposition of lockdowns, which will surely bring economic weakness in their wake. To make matters worse, the US remains paralysed by a surreal political crisis reminiscent of the worst banana republics, while the rest of the world is unable to coordinate a global response to the pandemic in the absence of US leadership as illustrated by the lacklustre outcome of the weekend's G20 Summit. As if that is not enough, central banks are running out of ammunition, while fiscal authorities have already spent such frightening amounts of money that debt loads will weigh down growth for years to come.

Yet, for investors with investment horizons longer than the lifespan of gnats there are at least three good reasons to be cheerful. First, they can look forward to the coronavirus outbreak soon being brought under control due to important recent advances on the vaccine front. Second, investors can look forward to far better economic data next year as economies bounce back, accompanied by impressive year-on-year base effects. Third, political uncertainty looks set to decline sharply as US President Donald Trump's farcical attempts to hold onto power finally reach their inevitable and ignominious end and President-elect Joe Biden's policy framework ushers in an air of normality and familiarity, which will be welcomed by rational people the world over.

In addition to these likely improvements in the global backdrop, EM investors in particular can look forward to making good money in 2021, since valuations in several markets are more attractive than they were at the start of 2020. For example, EM external sovereign debt currently pays investors a spread of 386bps over Treasuries, which compares favourably to less than 300bps paid at the start of 2020. The current valuation is even more attractive when one takes into account that several of the most vulnerable EM countries have already gone to the wall, with some already through their restructurings, such as Ecuador and Argentina, so the outlook going into 2021 is arguably less precarious than at the same time last year.

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Emerging Markets

However, the strongest case for investing in EM in 2021 does not even hinge on attractive valuations in the wake of the pullback caused by the coronavirus pandemic this year. After all, investors who genuinely want to exploit the excessive kneejerk selling of EM assets, which typically occurs in response to risk-off events, ought to have bought when markets bottomed out back in late March 2020. Instead, the case for investing in EM assets – stocks, FX, and bonds – today rests principally on still extreme mispricing between EM and developed market (DM) assets, which in turn can be attributed to massive changes in asset allocation triggered by central bank asset purchase programmes as far back as 2010. These distortions were already a powerful force for returns prior to coronavirus, especially after the start of the Fed hiking cycle in late 2015. As illustrated in Figure 1, EM local currency bonds have returned 9.17%, external debt 10.12%, high yield corporate debt 9.85%, and EM equities 15.48% in USD terms per annum since the start of 2016.

Fig 1: **2020 returns and annualised returns since the start of 2016 (in USD terms)**

	2020	Annualised return since start of 2016
GOVERNMENT BONDS		
EM local currency bonds	**-0.91%**	**9.17%**
3-5yr UST	*5.95%*	*4.10%*
EM external debt (USD)	**3.24%**	**10.12%**
7-10yr UST	*10.31%*	*6.43%*
CORPORATE HIGH YIELD		
EM corporate debt (USD)	**5.11%**	**9.66%**
EM HY (USD)	**-2.91%**	**9.85%**
US HY	*4.40%*	*11.30%*
EU HY	*0.24%*	*6.24%*
CURRENCIES		
EM spot FX	**-7.35%**	**-1.70%**
EM FX forwards	**-0.43%**	**4.45%**
DXY Index	*-4.15%*	*-1.71%*
EURUSD	*5.73%*	*2.08%*
USDJPY	*-4.37%*	*-2.23%*
STOCKS		
EM stocks	**10.86%**	**15.48%**
EM Small cap	**8.26%**	**8.50%**
Frontier Markets	**-3.96%**	**7.52%**
US stocks	*11.95%*	*20.09%*

Source: Ashmore, Bloomberg. Daily data as at 20 November 2020.

Despite the impressive returns over the last five years, there is every reason to expect EM assets to outperform DM asset in the years ahead, because global markets remain extremely distorted. The valuation differential between EM and DM equities has stabilised since late 2018, but EM equities are still some 60% cheaper than US equities based on a long-term price earnings as shown in Figure 2. In currency markets, EM currencies remain about 30% cheap to the Dollar in real terms as shown in Figure 3. Finally, as Figure 4 shows, bond yields in EM and DM are so different that they almost appear to be from different planets. EM Dollar-denominated bonds currently pay 6.25 times higher yield than US bonds of the same duration. Even taking into account the average annual default rate for EM sovereign bonds, EM bonds still pay more than 5 times more than US bonds. EM local bonds with five years of duration pay more than 200bps positive real yield. The US government 5-year real yield is -1.25%.

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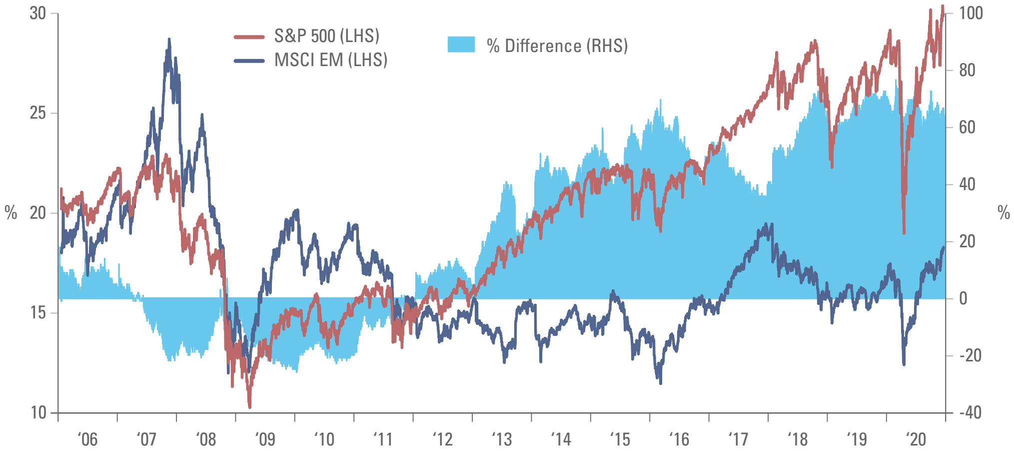
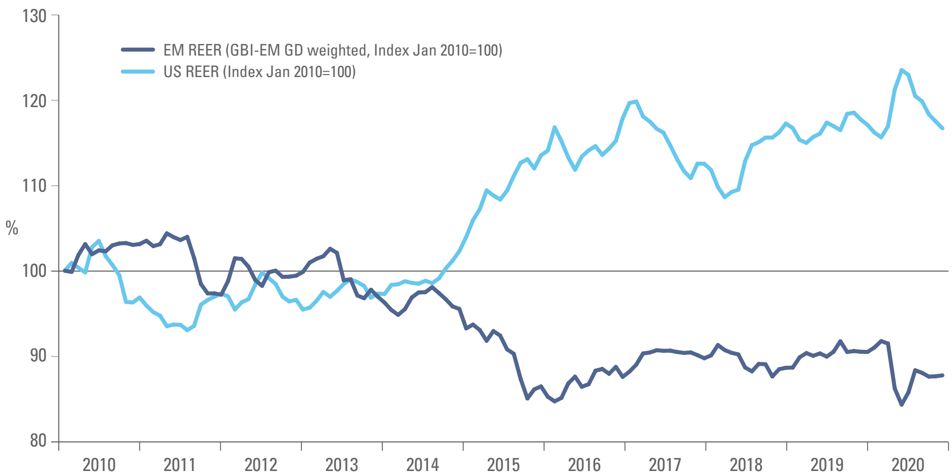
Emerging Markets

Fig 2: **Long-term price earnings ratio**



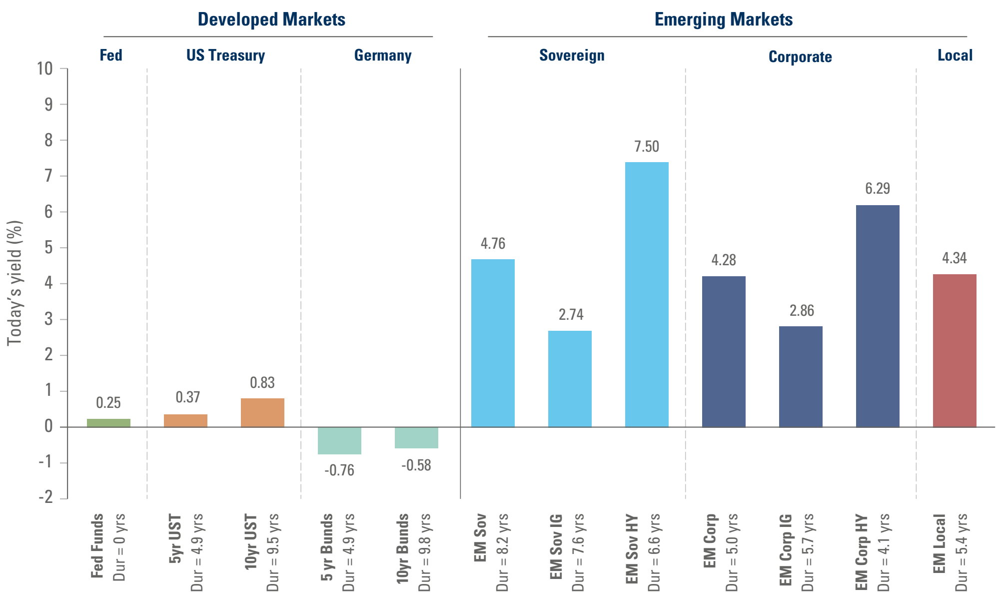
Source: Ashmore, Bloomberg. Daily data as at 20 November 2020.

Fig 3: **Real effective exchange rates**



Source: Ashmore, Bloomberg. Monthly data as at 31 October 2020.

Fig 4: **Bond yields**

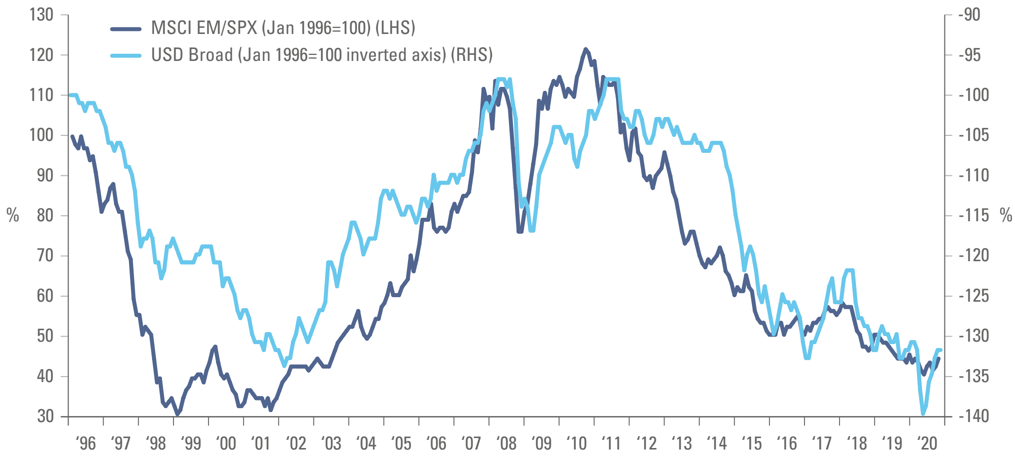


Source: Ashmore, Bloomberg. Monthly data as at 31 October 2020.

Emerging Markets

Value is not always associated with returns in EM. Typically, the key to turning value into actual returns is flows. Flows, in turn, are often sensitive to currencies. Here too, there is good news. This year the Dollar has only managed to rise on bad news; long gone are the days when the Dollar rose due to attractive valuations and the prospect of cyclical upside in the US economy. Positive news now drives the Dollar lower. That is why the prospect of good news in 2021 is so important for EM; investors can look forward not only to greater inflows to the asset class, but also stronger growth as a direct result of the inflows. This is because EM economies are severely finance constrained. The average DM has 3.6 times more finance than GDP, but the average EM country has less finance than GDP. This imbalance in the allocation of capital means that the marginal outflow of capital from DM tends to have very little impact on DM growth, but the marginal inflow tends to be extremely potent for growth in EM. Inflows are likely to be particularly supportive for EM equity markets due to the strong inverse relationship between the value of the Dollar and the relative performance of EM equities compared to US equities (Figure 5).

Fig 5: **Relative EM equity performance and the Dollar**



Source: Ashmore, Bloomberg. Monthly data as at 31 October 2020.

- **Turkey:** Central bank of Turkey (CBT) hiked the one-week policy rate by 475bps to 15%. This was in line with consensus expectations. More importantly, CBT signalled that the monetary policy framework will be simplified with all liquidity provided solely though one-week repo auctions. Following the rate hike, the real policy rate is now 5.7% on an ex-ante basis (against 1-year inflation expectations) and 3.0% on an ex-post basis (versus inflation over the last 12 months). The new higher level of real rates is likely to help to contain rapid credit expansion and to increase domestic savings, which in turn may stem outflows and ease pressures on TRY. However, the big question remains whether President Recep Tayip Erdogan will allow the new monetary policy regime to remain in place for long. Ominously, shortly after the rate hike, Erdogan repeated his old mantra that high interest rates leads to high inflation. This is pure economic illiteracy.

- **Peru:** Two centrist parties in parliament elected Francisco Sagasti as caretaker president until elections, which are due to take place in April 2021. Sagasti has appointed an orthodox cabinet and political noise could now subside for a time. A poll by Ipsos showed that George Forsyth, a former goalkeeper, is leading in voting intentions with 19% support in a crowded field of 23 candidates. No other candidate currently has more than 7% support, including Keiko Fujimori with 5% support and leftist candidate Veronika Mendoza with 6%.

- **Thailand:** Bank of Thailand (BOT) kept its policy rate unchanged at 0.5% in line with consensus expectations, but announced new measures to facilitate greater purchase of foreign assets by local banks and retail investors. This is done in an attempt to slow the pace of appreciation of THB versus the Dollar. It is unlikely that the measures to contain currency appreciation will work, because the strong currency derives from Thailand's large external surplus and strong growth expected in 2021. Instead, it is likely that BOT may be forced to cut policy rates further in the next few months.

- **Indonesia:** Bank Indonesia (BI) cut its 7-day reverse repo policy rate by 25bps to 3.75%, which was a surprise for the market, which had expected no cut. BI still sees the IDR as fundamentally undervalued and expects the currency to continue to strengthen. BI also bought IDR 72tn of bonds in the primary market and IDR 270tn via private placements, thus completing 67% of its direct budget financing program. The current account registered a USD 1.0bn surplus in Q3 2020 following a deficit of USD 2.9bn in Q2 2020. This was the first quarterly surplus since 2011, driven by a USD 9.8bn surplus in tradable goods (up from USD 4.0bn in the previous quarter). The overall balance of payments reached a USD 2.1bn surplus in Q3 2020 due to investment inflows of USD 1.8bn and FDI of USD 1.1bn. There were USD 1.9bn of outflows from portfolio investors.

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Emerging Markets

- **China:** President Xi Jinping said China will cut import tariffs and increase the imports of high-quality goods and services to ensure that quality of life can improve in line with higher per capita GDP. Chinese officials also signalled willingness to join the Trans-Pacific Partnership (TPP), which was abandoned by US President Donald Trump in a move, which could further increase China's influence at the expense of the US. Meanwhile, confidence in China by global multinational companies rose to by 4 points to 34 in Q3 2020, which is the highest reading since Q3 2018, according to Morgan Stanley, a US bank. The improving sentiment towards China reflects strong earnings growth and a healthy trajectory for investment.

Snippets:

- **Angola:** Parliament approved the 2021 budget with a primary fiscal surplus target of 4.0% of GDP. Gross financing needs will decline to 16% of GDP in 2021 from 23% of GDP in 2020.
- **Chile:** The seasonally adjusted rate of real GDP growth rose 5.2% in Q3 2020 from -13.5% in Q2 2020.
- **Colombia:** Real GDP growth bounced 39.6% in Q3 2020 after contracting 50.5% in Q2 2020. The result was in line with consensus expectations.
- **Ecuador:** The government has revised spending in the 2021 budget to USD 32bn, which is 10% lower than the original draft budget.
- **Guatemala:** Fitch placed Guatemala on negative watch after the government missed a USD 15.75m coupon payment on its 2026 Eurobond. Guatemala's foreign currency rating is BB-. The government has a 30-day grace period to make the payment.
- **Hungary:** The National Bank of Hungary kept the policy rate unchanged at 0.6% in line with consensus expectations.
- **India:** Exports rose at a strong yoy growth rate of 22.5% in the first week of November as power demand and rail freight continued to expand.
- **Nigeria:** The yoy rate of consumer prices index (CPI) inflation rose to 14.2% in October from 13.7% yoy in September as food prices rose at a yoy rate of 17.4%. Floods in the northern regions, FX shortages, and import constraints contributed to the rise in inflation.
- **Philippines:** The central bank cut the policy rate by 25bps to 2.0% in a surprise to the consensus expectation for no cut. The sluggish economic recovery due to slow loan growth amidst a series of typhoons prompted the authorities to further ease financial conditions.
- **Russia:** The yoy rate of CPI inflation rose to 4.0% in October from 3.7% in September, in line with consensus expectations and the central bank's target.
- **South Africa:** The South African Reserve Bank (SARB) kept its monetary policy rate unchanged at 3.50% in line with consensus expectations. However, two out of five voting members favoured a cut of 25bps. The yoy rate of retail sales declined 2.7% in September after falling 4.1% in the month of August.
- **Sri Lanka:** The government unveiled the 2021 budget with a fiscal deficit of 8.9% of GDP compared to a deficit of 7.9% of GDP in 2020. The deficit for 2019 was revised to 9.6% of GDP from 6.8% of GDP in recognition of government payment arrears.
- **Zambia:** The current account surplus rose to 3.8% of GDP in Q3 2020 from 2.2% of GDP in Q2 2020 on the back of a 40% rise in copper exports. In addition to higher copper prices, copper production rose 9.5% on a yoy basis to 646k tons in the first three quarters of 2020. In spite of the higher surplus, FX reserves declined to USD 1.3bn from USD 1.4bn due to outflows and debt service. Bank of Zambia kept its policy rate unchanged at 8% in spite of rampant inflation, which is now running at a yoy rate of 16%. China's Exim-Bank agreed to delay USD 110m of interest and principal payments from May to December.

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Global backdrop

- **Coronavirus:** Moderna, a drug maker, announced that its coronavirus vaccine is expected to remain stable at standard fridge temperatures of 2° to 8°C for 30 days, which is up from a previous estimate of 7 days. The Chinese vaccine developed alongside the Butantan Institute in Brazil also showed efficacy rate above 90% in recent studies. A cocktail of medications developed in Oxford UK looks set to be affordable for populations in low to middle-income countries.

- **US:** US Treasury Secretary Steve Mnuchin said the Fed's emergency lending facilities established under the CARES Act, including two corporate credit lines and a municipal funding facility, will expire in December. Mnuchin's decision received pushback from the Federal Reserve (Fed), which prefers that all emergency facilities remain in place as a backstop for the "still-strained and vulnerable economy". The Fed is afraid that investors, who purchased corporate debt on the assumption of a credit safety net may now liquidate assets, leading to tighter financial conditions for corporations. The incoming Biden Administration could reinstate the emergency lines, but this would still imply a time gap during which the Fed would not be able to support corporate and municipal bond markets.

  In political news, election officials in the State of Georgia certified Joe Biden as winner by 12.3k votes ahead of Donald Trump, who is still refusing to accept that he will go down in history as a 'loser president' like other one-termers, including Jimmy Carter and George Bush Senior. In US economic news, markets will look forward to this week's initial jobless claims numbers after initial jobless claims last week rose to 742k in the week ending in 14 November from 711k in the previous week. Initial jobless claims is one of the best high frequency economic data releases and the fear is that claims will rise as a result of renewed lockdowns in parts of the US due to rising coronavirus cases. Other data releases, including retail sales and industrial production, were broadly in line with consensus expectations.

- **Japan:** The yoy rate of CPI inflation declined to -0.4% in October from 0.0% yoy in September. The low print was partly due to the waning impact of last year's VAT hike. Increased savings amidst a weak labour market may also have contributed to softer prices, since wages declined at a yoy rate of 0.7% in September.

Benchmark performance

Emerging Markets	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
MSCI EM	9.62%	11.90%	10.86%	17.86%	4.93%	10.43%
MSCI EM Small Cap	11.33%	10.72%	8.26%	14.91%	1.10%	5.94%
MSCI Frontier	4.02%	5.12%	-3.96%	0.36%	-0.37%	4.27%
MSCI Asia	8.82%	11.87%	18.17%	24.93%	6.79%	11.97%
Shanghai Composite	4.75%	4.99%	13.33%	18.75%	2.26%	0.81%
Hong Kong Hang Seng	8.13%	12.34%	-1.78%	3.32%	0.90%	4.53%
MSCI EMEA	13.79%	9.13%	-12.46%	-8.93%	-2.35%	2.61%
MSCI Latam	19.89%	18.54%	-24.06%	-16.26%	-4.76%	3.96%
GBI EM GD	5.32%	5.77%	-0.91%	2.55%	3.04%	5.03%
ELMI+	3.28%	3.72%	-0.43%	1.67%	1.09%	2.77%
EM FX Spot	4.23%	4.31%	-7.35%	-4.90%	-4.62%	-2.64%
EMBI GD	3.80%	3.77%	3.24%	5.74%	4.78%	6.30%
EMBI GD IG	2.44%	2.53%	8.47%	9.71%	7.51%	7.25%
EMBI GD HY	5.49%	5.30%	-2.91%	0.92%	1.65%	5.12%
CEMBI BD	2.20%	2.46%	5.11%	6.37%	5.52%	6.37%
CEMBI BD IG	1.46%	1.72%	6.41%	7.09%	6.14%	5.87%
CEMBI BD Non-IG	3.25%	3.51%	3.25%	5.28%	4.69%	7.21%

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Benchmark performance

Global Backdrop	Month to date	Quarter to date	Year to date	1 year	3 years	5 years
S&P 500	8.94%	6.04%	11.95%	16.59%	13.43%	13.46%
1-3yr UST	-0.01%	-0.05%	3.06%	3.24%	2.72%	1.88%
3-5yr UST	0.01%	-0.26%	5.95%	5.85%	4.16%	2.95%
7-10yr UST	0.29%	-1.01%	10.31%	9.14%	6.48%	4.56%
10yr+ UST	1.90%	-1.17%	19.92%	16.57%	10.94%	8.34%
10yr+ Germany	-0.69%	1.29%	8.73%	5.44%	7.87%	5.52%
10yr+ Japan	0.51%	0.23%	-1.63%	-1.97%	1.74%	3.06%
US HY	3.23%	3.75%	4.40%	6.97%	5.57%	7.48%
European HY	3.54%	3.78%	0.24%	2.13%	2.33%	3.97%
Barclays Ag	1.54%	1.63%	7.45%	7.88%	4.62%	4.51%
VIX Index*	-37.66%	-10.13%	71.99%	92.06%	139.88%	51.73%
DXY Index*	-1.75%	-1.59%	-4.15%	-5.66%	-1.79%	-7.20%
CRY Index*	7.90%	5.16%	-15.95%	-13.42%	-18.50%	-14.87%
EURUSD	1.80%	1.16%	5.73%	7.09%	1.06%	11.38%
USDJPY	-0.76%	-1.54%	-4.37%	-4.37%	-7.78%	-15.43%
Brent	20.02%	9.79%	-31.88%	-27.95%	-27.74%	0.67%
Gold spot	-0.42%	-0.79%	23.31%	27.14%	46.53%	73.58%

*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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