

Developing Markets Insight

MARKET REVIEW

October heralded a welcome break from five months of negative returns for GEM equities with an advance of 7.1%. Asia led the way gaining 7.8%. All countries were in positive territory, particularly Indonesia with a leap of 15.8%, making it the best of the 23 GEM constituents. China is back in the black for the year (+5.9%), being 9.1% higher in the month. Latin America enjoyed a rare respite and increased by 6.1%. Again, all countries were up, particularly helped by currency strength in Colombia where the peso's appreciation of 6.3% left it top of the region rising 8%. Brazil broke a third quarter rout of 34% with a 5.2% improvement. EMEA progressed 5.4%. Turkey jumped 12.3% and the market was a more reliable augur of the election result than the opinion polls, which did not predict the recent victory achieved by President Erdogan's AKP.

All sectors advanced, Energy the most, as crude oil held above \$45. Telecommunications achieved a more measured increase of 2.5%

AKP VICTORY IN TURKEY

Three million Turkish voters made a U-turn in the second round of the parliamentary elections on 1st November and switched their allegiance to Erdogan's AKP from the nationalist MHP and pro-Kurdish HDP parties. This ran contrary to all pre-election polls. AKP support was up 8% and this gave the party back the majority in parliament which it lost in June 2015.

The victory was a result of President Erdogan's quite risky strategy of stalling all coalition efforts following the hung first round of elections and significantly hardening his stance towards the pro-Kurdish HDP and their military wing, the PKK. The AKP benefited from a significant rise in fears about security as well as from the economic weakness which has been driven by increased terrorist attacks and the decline of the Turkish lira through the summer of 2015. This resulted in a "natural flight" of voters to Erdogan's message of stability which the single rule of AKP delivered through 2002–2014. Return of the AKP's single party rule is positive for overall economic stability and for investor sentiment; it comes, however, with the possibility of a future referendum on constitutional changes which are likely to increase the powers of President Erdogan further.

Hence, while we expect to see short-to-medium term positive momentum in the Turkish economy with a stronger currency, lower funding rates and improving consumer and business confidence, we cannot exclude a significant push by President Erdogan and the AKP for a referendum on the constitution as early as spring 2016 in order to capitalise on the strong parliamentary election result. This will undoubtedly increase the market's fear of Erdogan's authoritarian tendencies, the recent arrests and asset seizures of business groups opposed to his presidency (Dogan, BankAsya, Ipek, Boydak, etc.) being a good example.

ARGENTINA ELECTIONS

Argentina has just undergone its five yearly trip to the Presidential elections and this one was watched with particular interest by potential investors. The reason for this was that this election brought the end of the Kirchner era. Incumbent Christina and her husband previously, have held the top post since 2003. Constitutional rules forbid a third term. Christina had hinted at changing that law but did not have the required two thirds support in the legislature.

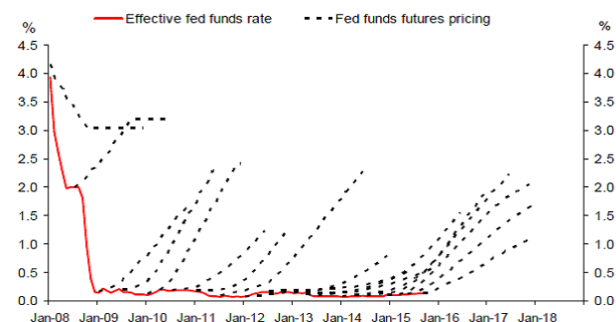
The opinion polls suggested a possible outright, first-round victory for Daniel Scioli. He had aligned himself with Kirchner who is still relatively popular. In the end the contest was much closer with Scioli getting 36% and Marcelo Macri 34%. This leads to a two-way run-off at the end of November. Macri now has a 10% lead in the polls which given their track record, might need to be taken with a pinch of salt. A Macri victory would be welcomed by the markets since he has campaigned on radical action to fix the economy, compared to the gradualist rhetoric of Scioli. Three key things are amiss: an overvalued official exchange rate, 20%+ inflation and no access to international sovereign finance due to holdout injunctions. The solution looks to be a painful period of recession which thus far has been neverendingly postponed by money printing. The market rocketed 45% in October preferring to travel hopefully, pending the possible painful reality of austerity.

PREDICTION IS VERY DIFFICULT, ESPECIALLY IF IT'S ABOUT THE FUTURE

Our base case at Blackfriars has been that there would be no increase in interest rates by the Fed this year. We have (so far) been correct. However, two charts recently published by Deutsche Bank remind us that forecasting US rates (or indeed any other economic variable) is not something the market is very good at. Wall Street economists have spent the last ten years consistently getting their forecasts wrong.

This is not an attempt to suggest that we are better than the massed ranks of economists or futures traders out there, far from it. It simply demonstrates that we should be extremely wary of over reliance on forecasts.

The futures market in the US has been pricing a Fed 'liftoff' since 2009



Source: FRB, Bloomberg, DB Global Markets Research

Actual 10y rate and forecasts for the 10y rate from the Fed's quarterly 'Survey of Professional Forecasters'



Source: FRB, FRBPHIL, Haver Analytics, DB Global Markets Research

AL, BR & TH

This document is intended solely for Professional Investors and should not be relied upon by any other persons. This document does not constitute investment advice and should not be regarded as constituting a distribution, an offer or solicitation to sell shares or units in any of the Blackfriars Asset Management funds in any jurisdiction in which such distribution, offer or solicitation would be contrary to local law or regulation. Past performance is not a guide to future returns. The value of investments and the income from them can go down as well as up and an investor may not get back the original amount invested. This document is for information only. The information and opinions contained have been obtained from sources believed to be reliable but no representation or warranty is made as to their accuracy, completeness or correctness. This document is being issued by Blackfriars Asset Management Limited, authorised and regulated by the Financial Conduct Authority in the United Kingdom and is also a registered investment adviser with the United States Securities and Exchange Commission under the Investment Advisers Act of 1940.