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Developing Markets Insight

Market review

July was a strong month, as markets recovered from the Brexit shock. Of the 21 trading days, 16 were positive, leading to a return of 5%. This leaves the asset class with a gain of 11.8% for the year. This is currently ahead of the Developed World, which has risen 4.9%. From the January low, Emerging Equities have rallied 28.9%.

Latin America continued to lead the regions, advancing 5.52%. Once again the only real story continues to be Brazil. The country jumped 10% as the political landscape continues to re-shape. The expectation is that suspended President Rousseff will be impeached. That leaves acting President Temer to open the Olympics. More relevantly, he can take difficult decisions without the apparent desire to stand for election in 2018. One of Brazil's weaknesses has been populist policies, which did not address the imbalances. Colombia was GEM's worst market, losing 5.8%, wholly attributable to currency weakness. The peso lost 5.9%, in spite of overnight rates being hiked to 7.75%. The market is concerned by rising inflation, which stands at a lofty 8.6% y-o-y.

EMEA was very close behind, advancing 5.49%. Egypt surged 20.8%, helped by international expansion from Global Telecom Holdings into Pakistan. More importantly South Africa, which represents half of the region by weight, improved 8.8%, aided by rand appreciation of 5.3%. The country enjoys the current situation of falling crude oil/rising precious metal prices. Brent blend lost 14.5% while platinum added 12.1% in July. Turkey was one of the few falling markets, retreating 5.8%. This followed the failed attempted coup d'état. For context, the market had been strong for the beginning of July.

Asia saw an accretion of 4.8%, led by Thailand's 7.3% advance. South Korea improved 6.1%, with Samsung Electronics regaining its status as GEM's largest stock (3.6%). The stock is re-visiting its all-time high. The technology hardware sector was buoyed by Apple's Q2 income beating expectations. China ground out a 3.5% gain. The Q2 GDP growth of 6.7% was ahead of forecasts. All the region's markets were in positive territory, except Malaysia, which lost 0.8%, in spite of a 0.25% cut in interest rates.

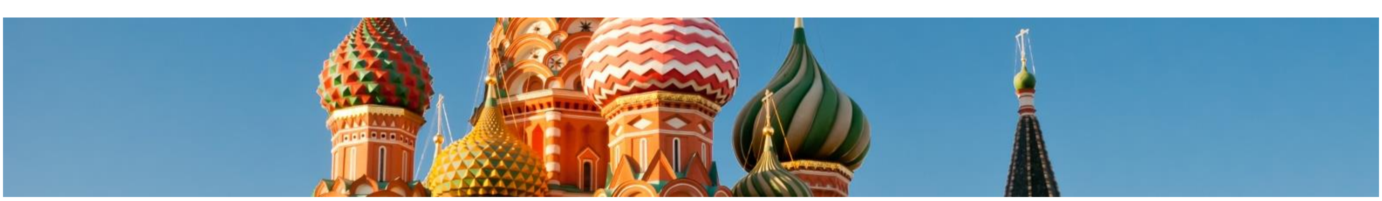
All sectors were positive, with Materials in the lead (+9.6%) helped by cement and steel stocks. Consumer Staples was the relative laggard, only gaining 0.7%.

Failed coup in Turkey

Extreme political events like coups almost always lead to extreme financial market volatility. Sometimes the aftermath of the coups can present good buying opportunities. That's currently the case in Turkey, we believe. The attempted military coup that took place in Turkey on 15th July 2016 laid bare the recent hidden conflict between previous allies President Tayyip Erdogan and religious Islamic cleric Fethullah Gülen. Several army and air force detachments attempted to take control of the Parliament in Ankara as well as airports, bridges and TV stations in Istanbul, with the army's Chief of Staff taken hostage. The coup failed and, in the aftermath, the Turkish government embarked on a wide-scale agenda of cleansing its military forces, police, education and other state institutions of Gülen supporters, suspending over 50,000 people from their positions.

While Turkey has a long history of military coups, we see the aftermath of this latest coup attempt as positive for the country for a number of reasons. Firstly, Turkish society as a whole (as well as all political parties, irrespective of affiliations) united against the coup, helping the country successfully pass a critical test of its democracy. Secondly, we believe that the increase of Gülen's power and his recent regular interference in political and judicial processes was a major negative for Turkey in the medium term and needed to be addressed. It is positive that after this unsuccessful coup Turkey is getting rid of a shadow power structure which could have grown in to a much larger organisation. Thirdly, while consumer confidence underwent a temporary setback, the Turkish economy is in a very comfortable place with historically low bond yields and ample global liquidity which can support Turkey's current account position for at least another six months. This was borne out by the very modest movement in Turkish lira and bond yields. Moreover, Erdogan and the government unearthed wide-scale plans to support economic growth and restore business and consumer confidence which should bear fruit in 2017.

While there are increasing indications that President Erdogan may push for constitutional change towards a 'Presidential democracy', we note that in order to be able to prevail in the conflict with Gülen, Erdogan needs the support of the largest political parties like the Republican People's Party (CHP) and Nationalist Movement Party (MHP). We think that this will put some boundaries on his ambition and on the risk of outright autocracy. Although we believe that Turkish constitutional change is inevitable in the coming months, the balance of political power in Turkey has moved from an Erdogan-Gülen alliance against the secular Kemalists to an Erdogan-Kemalist alliance against Gülen, which we see as positive since it moves Turkey in a more secular direction.



Indonesian politics

In Indonesia, President Joko Widodo (Jokowi) demonstrated his increasing dominance over Indonesian politics with a cabinet reshuffle at the end of the month.

By re-appointing the tough-minded and independent Sri Mulyani Indrawati as Finance Minister, he is signalling a stronger commitment to reforms and an inclination to allow liberalising changes. Sri Mulyani was a market favourite when she previously held the post under former President Yudhoyono. She managed the strains that Indonesia came under during the global financial crisis competently, and showed courage in tackling vested interests vigorously. Her appointment would also seem to demonstrate a greater ability and/or willingness to stand up to other powerful political figures. Sri Mulyani had been reportedly ousted from her first stint as Finance Minister because of pressure from Aburizal Bakrie, former leader of Golkar and head of the Bakrie business group.

He has also shown a deft touch in bringing in new party allies but managing not to upset his nominal party boss in the Indonesian Democratic Party of Struggle (PDI-P), former President Megawati, by retaining most though not all of her key allies, including her daughter Puan Maharani. Of course there have been some compromise appointments, but the overall conclusion is positive.

As he approaches the second anniversary of his inauguration, Jokowi will be well aware that he is now in that critical phase before the 2019 presidential election when he has to deliver tangible signs of progress to voters. This reshuffle should lead to more growth-enhancing reforms and we remain upbeat on the long-term outlook for Indonesia.

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