www.blackfriarsam.com
+44 (0) 20 7332 2270

BLACKFRIARS ASSET MANAGEMENT

# DEVELOPING MARKETS INSIGHT

2nd February 2017

## Market review

GEM equities began the year well, gaining 5.5% in January, with 12 out of 22 days showing advances. This is the best start to a year since 2012. The weaker US dollar was positive for returns. The developed world returned 2.4%.

Latin America picked up where it had left off in 2016, jumping 7.6%. Once again the main propellant was Brazil, with a jump of 10.7%, making it GEM's best market. This continued momentum was led by iron ore giant Vale, buoyed by the commodity's price doubling from its 2016 low. The Selic overnight rate was also cut more than expected. Peru improved 9.1%, also aided by metal price strength in gold, silver and copper. Mexico was the region's laggard, only gaining 2.2%. The currency did hit an all time low, 22 pesos to the US dollar. However it rallied 5% in the second half of the month.

Asia was also strong, with an accretion of 5.9%. All 8 countries were in the black. South Korea was top of the regional pack, progressing 7.7%. The strength in DRAM chips is helping companies such as Hynix and Samsung Electronics. China broke a three month losing streak, with an increase of 6.8%. Fourth quarter GDP came in line with estimates at 6.7%. The Philippines continued its recovery, adding 5.7%. Indonesia just scraped into positive territory, at +0.1%.

EMEA was the weakest region, with an accretion of 2.1%. It was held back by Russia's weakness, slipping 0.3%, in the face of crude oil's 2% decline (Brent blend). Poland was the best market, surging 10.5%, helped by a 39.5% leap in copper producer KGHM. The region's largest country, South Africa, was relatively calm, improving 2.8%.

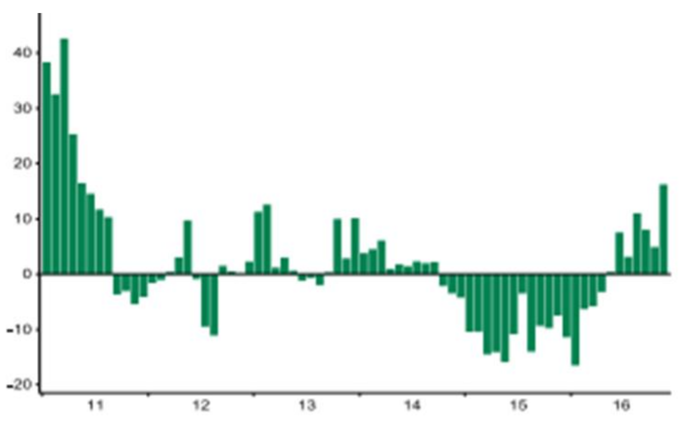
In January the best sector was Materials, up 10.2%. The worst was Consumer Staples, only up 2.6%, held back by weakness in Russian retailer Magnit.

## Asian export revival

Watching the news or reading the papers at the moment can be quite depressing given the coverage of Brexit and President Trump. However, not all is doom and gloom. A recent note by the BNP macro team notes that after an 18-month recession, Asian exports have staged a solid recovery since mid-2016. In fact, helped by base effects, annual growth hit a five-year high in November.

Asia's export performance was weak in 2015 and early 2016. Exports in USD terms for the region (outside heavyweight China) dropped in year-on-year terms throughout 2015 and the first seven months of last year. They have, however, enjoyed an increasingly robust recovery since last summer: exports from the region registered positive year-on-year growth for a fourth month in a row in November. Base effects have inevitably played some role, but there has also been clear sequential improvement, with the six month rate rising to 16% annualised; the highest since H1 2011 (see chart below). Partial data already available for December suggests further acceleration.

**Asia ex-Japan and China exports (USD terms)**
**% 6 month annualised**




*Source: National statistic offices, CEIC, Macrobond, BNP Paribas*

There are three key elements of global trade and wider global macro momentum: G2 final demand, Chinese industrial momentum (and the associated demand for industrial commodities), and global tech demand. There has been a clear impact on Asian exports from booming tech demand. Exports of electrical machinery were buoyant in the second half of last year, jumping at a 23% annualised rate in the six months to November; easily the strongest pace since mid-2010. The impressive rebound in China's industrial demand has been the second key to the region's export recovery.

*Returns are in US dollars*

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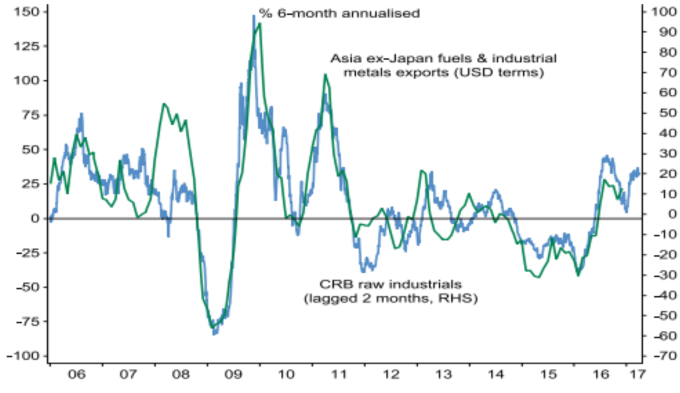
China's goods-import volumes have surged in recent months, forging ahead by 22% annualised in the six months to December. With China a price-setter in most commodity markets, accelerating mainland demand has, in turn, also boosted industrial commodity prices despite the stronger USD.

The CRB 'raw' industrials price index excludes heavily 'financialised' commodities such as oil and gold and is typically seen as a purer read on the strength of global, especially Chinese, industrial demand. The index correlates closely with Asian exports of 'fuels and industrial metals'.

**Industrial commodity reflation**




*Source: National statistic offices, Bloomberg, CEIC, Macrobond, BNP Paribas*

The final piece of the jigsaw, an upswing in G2 industrial and critically capex demand, seems to be now slotting into place, offering up the prospect of more export upside to come from the region in H1 2017. The ISM new orders balance jumped to 60.3 in December, its highest reading since November 2014. Inbound containers at US west-coast ports are also accelerating strongly. Other gauges of US corporate spending intentions, particularly the bellwether Philly Fed capex intentions balance, have also bounced.

Overall, US corporate 'animal spirits' look to have been lifted by the prospect of faster demand growth and less regulation under a Trump presidency, adding to upside risks. Demand in the eurozone has also been surprising to the upside, quietly but consistently, with the PMI manufacturing orders hitting levels not seen since H1 2011.

This suggests both that world trade is potentially firing on all cylinders in early 2017 for the first time in over five years and, critically, that Asia's export recovery should gather further strength over the next quarter or two even if tech demand (inevitably) loses some momentum.

*AL, BR & TH*