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

BLACKFRIARS ASSET MANAGEMENT

DEVELOPING MARKETS INSIGHT

2nd February 2017

Market review

GEM equities built on the positive start to the year, gaining 3.1% in February, with fourteen out of twenty days showing advances. This leaves the benchmark's increase at 8.7% for the year to date. The developed world returned 2.8% for the month, and 5.3% for the year.

Asia was the best region, improving 3.64%. India was the lead market, jumping 5.9%, helped by a budget that aims to boost consumption, and did not introduce a feared capital gains tax. China continues to prosper. The renminbi, having depreciated 7% in 2016, has slightly appreciated this year. In addition, nominal GDP growth looks set to be over 10% this year. The only negative market was the Philippines, slipping 1.1%. It continues to be hampered by the tenure of president Duterte. This month an opposition senator alleged graft charges.

Latin America was close behind, with an accretion of 3.57%. Brazil continues to lead the way, with an increase of 4.4%. The monetary easing cycle continued with a Selic rate cut of 0.75% to 12.25%. The Central Bank governor opined that inflation could reach its upper limit target of 6.5%. Mexico continued to recover from its Trump slump. The index rallied 3.4%, more than wholly attributable to the peso's 3.7% appreciation. Banixco raised overnight rates by 50bps to 6.25%. The currency has recovered 11.5% from its November 2015 low. Colombia was the worst market, losing 2.8%. The country's banks have been hit by concerns regarding bribery from Brazilian construction companies, mainly Oderbrecht, in respect of infrastructure projects.

EMEA was the weakest region, just scraping a 0.1% rise. It was held back by Russia's 6.4% slippage. There has been profit-taking in the Energy sector. Nevertheless, the rouble continued to appreciate a further 2.8%, taking its rally to 30% versus one year ago. Egypt was the best market, leaping 11.2%, all thanks to the rally of 16.6% by the pound. The local currency had overshot in 2016's devaluation, and is now finding a more appropriate level.

In February the Industrial sector was the best, up 4.8%, helped by strength in cyclicals, such as ship builders. The worst was Energy, down 0.9%, hit by Russian energy stocks, as mentioned above.

GEM equities and Trump's first 100 days

Although his inauguration was only in January, February still marks 100 days since his election victory. Given the unexpected nature of the result, it was perhaps no surprise that higher beta assets – such as GEM equities – were hit. The MSCI GEM benchmark lost over 7% in the week after the November election. With hindsight, this would have been an excellent entry point, given the subsequent 11.6% recovery. Most of this has occurred in 2017.

One reason for the recuperation has been the scope for self-help, ranging from currency-protecting rate hikes in Mexico, an expansionist budget in India and reserve depletion in China. Most GEM countries have the capacity to provide counter-cyclical measures. One might have expected Asia to have been hit by trade concerns, given the Trump rhetoric about "America first". However, the region is up 10.7% from its Trump low. Trump has also talked about getting Apple to make handsets in the US, and yet Hon Hai, a major Apple supplier, has rallied 16.6%.

A cynic might suggest that these are simply "risk-on" trades, as GEM, and especially Asia, catch up with the developed markets' appetite for pro-cyclical stocks. A pessimist might think that Trump's trade toughness has not taken hold thus far. An optimist might hope that Asia is increasingly trading within itself, whilst growing impressively. Recent nominal GDP growth rates for the US, Europe and Japan have been 1%-4%. For Asian economies, the average has been closer to 10%. American trade protectionism will hurt. It will also cause a jump in US inflation, whilst the real growth for the world happens in Asia.

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

DEVELOPING MARKETS INSIGHT

Re-Polonisation

The Polish Law and Justice Party (PiS) came into power in late 2015: another sign of European politics turning decisively to a populist left with a pro-nationalist agenda. The headlines were dominated by the populist 500 zloty family subsidies, and Swiss franc-denominated mortgages. The less apparent trend was the push to re-Polonise key sectors of the Polish economy, including banks and energy.

PiS's political argument is the belief that "Capital has nationality" and that a higher share of banks' ownership by local institutions is needed. In a clear trend, foreign ownership of Polish banking assets has dropped from 72% at its peak in 2008 to 59% by 2015. Most of this decline occurred through the "natural" desire of foreign banks to sell and shrink their operations after the 2008 financial crisis. The last fifteen months were dominated by PiS's policy of further domestication, and resulted in a further decline in foreign ownership to 54% by October 2016.

Now, more than a year after PiS's push, it is possible to state that through PZU acquisitions of Alior and 32.8% of Bank Pekao, not only domestication but also state influence over the Polish banking system have noticeably increased. The trend will undoubtedly continue with the PZU Group eyeing acquisition of Raiffeisen (and possibly Deutsche Bank's Polish assets?), and Alior Bank's finalising purchase of 87% shares of BPH bank from the American GE. Hence, serious questions arise with regards to the magnitude of the state's grand designs to "re-Polonise" and potentially "re-nationalise" the financial sector. Clearly the PiS policy of prohibiting dividend pay-outs from Polish subsidiaries to their Western European parent-banks (which are in desperate need of capital repatriations and support due to low capital adequacy ratios) has the main goal to "persuade" Western banks to dispose of their Polish assets to willing local Polish state buyers.

The Polish energy sector is likely to face a similar "re-Polonisation" push in 2017-2018, with the government actively supporting the purchase of the Polish assets of France's EDF and Energie by state-dominated groups PGE, Enea, Energa and PGNiG. There is also the possibility that the purchase of the construction company Polimex-Mostostal by a consortium consisting of Energa, Enea, PGE and PGNiG is on the cards. With a global wave of protectionism and pro-nationalism on the rise, PiS's economic policy should not be surprising. Nevertheless, in the mid term it will undoubtedly raise serious questions about the efficient state-ownership of commanding assets in the Polish economy.

AL, BR & TH