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

BLACKFRIARS
ASSET MANAGEMENT

DEVELOPING MARKETS INSIGHT

3rd August 2017

Market review

The positive mood in emerging markets equities continued, and indeed was invigorated in July. The benchmark returned 6%, with all country constituents improving bar Pakistan (-6.4% on prime minister's removal). 14 out of 20 trading days saw advances. The gain for the year now stands at 25.5%, with a 6% contribution from US dollar weakness.

Latin America was the best region, jumping 8.3%. Brazil rallied 10.9%, helped by a 5.7% appreciation of the currency. The market is not expecting another impeachment of the president. In addition, the overnight SELIC rate was cut by 1% to 9.25%, as inflation sank to a 10 year low of 3%. Chile has recently seen improved sentiment, and added 8.9% for the month, helped by copper price +14.7% this year, and former president Piñera advancing in election primaries, for a contest in November. Mexico was the relative laggard, up 4.2%, consolidating its recent rise.

EMEA was also strong, with South Africa defying recession and political turmoil to progress 6.8%, boosted by coal and gold miners. In addition, Naspers mirrored Tencent's 12.5% gain in July, since the former owns 33.2% of the Chinese internet giant. The best market was Hungary, up 7.5%. OTP Bank's acquisition in Romania was well received. Greece was the weakest market, edging 1% higher. The nation successfully returned to the bond market, issuing EUR 3bn of 5 year debt at a yield of 4.625%, the first such foray since 2014.

Asia returned a solid 5.6%, consolidating its position as the year's best region, now +30.1% for 2017 thus far. China led the way, with an accretion of 8.9%. Sentiment has moved from cautious to optimistic, as solid economic numbers prevail. The momentum is strong, especially in technology and property stocks. India improved 7.7%, boosted by banks. The benchmark is at a 10 year high, albeit still 14.3% below its USD high in 2007. Malaysia and Indonesia were becalmed, both flat for the month.

In July, Communications was the best sector, up 4.1%, boosted by Baidu's 26.6% jump on strong Q2 results. Health Care was the worst sector, down 2.4%, depressed by continued weakness in generic pharmaceuticals. The RJ/CRB commodity price index added 4.5%, as crude oil jumped 9.9% (Brent blend).

North Asia and Pakistan

The performance of emerging markets this year has been dominated by tech and North Asia. It is a fool's game trying to predict how long this might persist. The Chinese economy looks to be progressing steadily and we don't expect much change ahead of the important 19th Party Congress this autumn. The tech sector's performance has started to raise concerns that we may be entering 'bubble' territory akin to 1999-2000. Whilst some stocks do look expensive, valuations for the sector as a whole are not as elevated and, crucially, tech companies now are not just concepts but real businesses with real earnings and cashflows. Whilst a bout of profit taking would not be surprising given the strong moves YTD, we are comfortable to remain invested.

At the other end of the scale, the Pakistan market is not yet living up to expectations and has been the worst performing market in emerging markets this year. Foreign inflows following MSCI inclusion have been disappointing but the main fault line has been politics and the uncertainty surrounding the Prime Minister's hold on power. In an unprecedented move last Friday (28th July), the Supreme Court of Pakistan removed the sitting (now ex-) Prime Minister Nawaz Sharif from office by a unanimous vote of its five member bench during the final proceedings of the Panamagate case.

DEVELOPING MARKETS INSIGHT

The ruling party has unsurprisingly expressed reservations over the final verdict of the Supreme Court but its decision to honour the judgment should be taken positively. The ruling party has announced Shahid Khaqan Abbasi (formerly the Petroleum Minister) as interim Prime Minister for the next 45-50 days while Shahbaz Sharif (brother of Nawaz and current Chief Minister of Punjab) has been nominated by the party for the role of Prime Minister until FY18 elections.

The domestic business community feels the selection of Shahbaz Sharif is an appropriate choice for the Prime Minister's seat given his track record and project management skills; foreign investors may not be so sanguine but should be broadly encouraged that the peaceful removal of Nawaz Sharif via the due process of a judicial investigation is a step forward in the fight against corruption in the country.

The probability of an earlier election (due by August 2018) goes up and with it the likelihood of a modest devaluation (c5%) under the interim, caretaker government, which according to the Constitution, is tasked with overseeing the election.

Concerns exist over the external account and fiscal slippages though we maintain our positive outlook on GDP and believe progress on the China–Pakistan Economic Corridor will remain intact. We are in no hurry to jump in despite the recent sharp pull back but once the political dust has settled we may see opportunities. The KSE-100 index is currently trading at a PER of 9.4x (2017) compared to Asia Pac regional average of 13.4x while offering a dividend yield of ~5.2% versus ~2.6% offered by the region.

AL, BR & TH