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BLACKFRIARS
ASSET MANAGEMENT

# DEVELOPING MARKETS INSIGHT

6th June 2018

## Market summary

May was a weak month, the MSCI GEM Equity index suffering a loss of 3.5%. The majority of trading days were positive; however a couple of weak sessions at the beginning and end of the period dragged the index down.

The worst region was Latin America, which dropped 14.1%, dragged down by Brazil's 16.4% slump. The country has been hit by a truckers' strike over diesel prices. Ahead of October's Presidential election there is scant political leadership. All the other markets were depressed, Mexico gave up 13.7%, with nearly half of the damage stemming from peso depreciation. Colombia continued to be relatively resilient, losing 4.3%. The first round of the election leaves Ivan Duque and Gustavo Petro going into the second round. The former is favourite, and is positioned as a more market friendly candidate.

EMEA retreated 5.8%. Greece was the worst market in GEM equities, tumbling 18.8%. The political impasse in Italy raised concerns about Euro zone stability. This nervousness was especially evident in currency markets. Turkey lost 12.9%, as the lira retreated 11.6%. The central bank was forced into emergency rate rises. Hungary gave back 13.9%, of which the forint contributed 5.5%. The re-election of Viktor Orban, has continued the rift between the right wing President and EU officials over his anti-immigration stance. Russia was one of the few positive markets. It added 1.1%, buoyed by the 3.2% advance in crude oil (Brent blend).

Asia was the relative winner, only slipping 1.3%, held up by China's 1.8% improvement. Sentiment has swung dramatically, this month the reduction in import duty on cars from 25% to 10% was viewed as a fillip. All the other GEM Asian markets were in negative territory. Malaysia lost 8.1%, the market was surprised by the ending of a 61 year rule by the Barisan Nasional coalition, and the return of 92 year old Mahathir Mohamed as Prime Minister.

The worst market was Pakistan dropping 9.4%, it is scheduled to hold elections in July.

Financials was the worst sector, down 6.7%, as large banks were hit by the renewed risk-off trade. Health Care was the only positive sector, up 0.5%, benefiting from its defensive credentials.

## Brazil on strike

Latin America's largest economy has been hit by a strike amongst truck drivers. They are protesting the rising cost of diesel. Historically rising oil prices were countered by subsidies, which dented the profit of the state oil company Petrobras. It is estimated to have cost $40bn in foregone income. Following the bribery and corruption scandal which engulfed the company, new bye-laws were enacted which led to market pricing for fuel. However, the 16% rise in crude oil (Brent blend), coupled with a 12.3% depreciation in the real (YTD) has led to a shock on the station forecourts.

Brazil, like most of Latin America, is highly dependent on truck logistics, since railways are relatively undeveloped. The truckers blocked highways and ports for ten days. President Temer, whose popularity rating barely registers at 4%, was obliged to re-introduce subsidies. The strike will hinder an already anaemic growth recovery. It also continues the loss of faith in the government, leaving October's Presidential election wide open.

## Turkey

Turkey had one of its worst months for more than a year, being badly hit in May both on the equity market and the currency. The Turkish lira was the second worst performing currency in the world losing 11.9% and the markets overall declined by 12.6%. The main reasons for this were increasing political risks as the market started to price in risks of AKP-MHP not gaining 50% in the upcoming parliamentary elections.

*Returns are in US dollars*

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2nd May 2018

April's move of 15 members of Parliament from the CHP (the main opposition party to President Erdogan's AKP Party) over to the newly formed nationalist spinoff, IYI Party, has increased the risk of the AKP-MHP nationalist alliance not reaching the desired parliamentary majority in the upcoming elections on June 24th. The market was previously confident of President Erdogan winning the election in the first round and AKP-MHP securing control of the parliament. Recent polls now show 2-18% potential support for the newly-formed IYI Party which puts that AKP plan in jeopardy.

Erdogan's Bloomberg interview, in which he commented that he carries ultimate responsibility for monetary policy in Turkey didn't calm investors either. The Turkish lira corrected from 4.04 to 4.92 vs the US$, before Central Bank of Turkey actions (+300 bps hike of the key rate's lower corridor) stopped the TRY melt-down. That in turn has cut Turkish banks' 1Q 2018 earnings by 1-11%. Standard & Poor's lowered the long-term issuer credit ratings on four banks (Isbank, Vakifbank, Yapi Kredi and Garanti Leasing) to 'BB-' from 'BB'. We expect Turkey to continue to be very volatile ahead of June 24th, but we believe that at current levels the Turkish lira is fairly priced on a purchasing power parity basis. Risks linked to Halk Bank's US court case are still pending.

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