DEVELOPING MARKETS INSIGHT

4th December 2018

Market summary

November offered some relief from a difficult year, with an advance of 4.1% in the index. 13 trading days were positive, with nine in negative territory.

MSCI Emerging Asia was the best region, gaining 5.2%. The advance was led by China improving 7.3%, breaking a five month losing streak. The market has lost 32.9% from its January high. The market was helped by better than expected results from Tencent, its largest constituent. The best market was Indonesia, surging 12.3%. The rupiah gained 5.9%, as the benchmark interest rate was hiked 50bps to 6.5%. The central bank vowed to maintain a pre-emptive policy. India saw an advance of 10.4%, with more than half of the movement a result of 5.7% rupee appreciation. The country is a beneficiary of lower energy prices. Brent crude blend lost 22.2% in the month, its largest drop since October 2008. The region's worst market was Pakistan, slipping 5.5%. The currency depreciated 3.3%, as negotiations continue with the IMF over a USD12bn bailout.

EMEA rallied 4.5%, boosted by a re-pricing in Turkish assets, up 13.1%, recovering from the mid year collapse. The lira was the world's best currency, jumping 6.3%. The fall in oil prices will help curb its inflation problem. Given the oil price decline, it is surprising that Russia held steady, only slipping 1.2% (banks and retailers providing support). South Africa also enjoyed the prevailing sentiment of risk-on. The market improved 8.8%, with the rand boosting the return by 6.1%. UAE was the worst market, down 5.3%.

Latin America lost 2.2%. Mexico was the weakest component, shedding 4.8%. The market is concerned that incoming President Lopez Obrador might pursue populist policies. There has been pre-inauguration talk of curbing bank fees and mining permits. Brazil retreated 2%, after October's 17.8% rally. The real lost 4.3%. Benchmark heavyweight Vale was held back by iron ore's 12.4% rout. Chile was the best market, with an increment of 3.3%. Copper was a rare commodity to appreciate, with a 3.2% advance (LME spot).

Consumer Discretionary was the best sector, adding 9.8%, as airlines enjoyed the prospect of lower fuel costs. The worst sector was Energy, losing 0.8%.

Mexico

The Mexican market is one of the laggards in the GEM and Frontier universe for 2018. With a year to date negative return of 18.2%, it is on course for the worst year since 2008. After a landslide victory in the July Presidential election for Andres Manuel Lopez Obrador, one might have hoped for a period of calm. However the new leader, who took office on 1st December has spooked investors with his potentially populist policies. His political rhetoric has always alluded to higher social spending and public sector investment, so that has not been the surprise.

The shock has stemmed from his use of plebiscites to determine policy, and outspoken comments from members of his party. In the first instance the proposed new airport for Mexico City will be abandoned, even with $2bn of the budgeted $13bn already spent. This results from a nationwide referendum, where one million voters registered a 70% disapproval of the project. In the second instance comments from loyal Senators raised the prospect of curtailing bank charges and tighter environmental controls on mining. There clearly can be merit in these ideas; however the backdrop of ongoing trade negotiations to replace NAFTA and border skirmishes near San Diego, leave little room for shaking investors' confidence.

Romania

Romania is on track to become the best-performing market in Eastern Europe, returning +18% in US$ terms, year to date. The strength of the 2018 performance comes from the combination of factors that are currently hard to find elsewhere in the European emerging markets. Romania staged one of the most impressive deleveraging stories since 2008 with the banking system loans to deposits ratio (LDR) dropping from over 150% in 2008 to below 90% in 2018 (expected).

Moreover the share of FX loans in the book dropped from 18% 2Q08 to 8% in 2Q18 (one of the largest drops in the region).

This deleveraging created the basis for a stable GDP recovery with over 4% growth delivered for the third year in a row up till 2018. We expect some GDP moderation in 2019 to 3-3.5% (after 4.2% for 2018) but this still is a superior level versus other emerging European countries. Mildly depreciating Romanian currency (against Euro) should provide some additional support for Romanian industrial producers in 2019. Romanian equities valuations, despite the recent rebound, still remain very attractive – MSCI Romania Index trading at close to 3x EV/EBITDA for FY19, and 8x P/E FY19 or 1 standard deviation below the 5-year average. Superior dividend yield of 8% for both 2018 and 2019 represents more than twice the levels of MSCI EM (3.4% & 3.9%respectively).

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