www.blackfriarsam.com
client.service@blackfriarsam.com

BLACKFRIARS
ASSET MANAGEMENT

DEVELOPING MARKETS INSIGHT

6th February 2019

Market summary

Emerging Market equities enjoyed a strong start to the year, returning 8.8% in January. This is the best start to a year since 2012. All markets, with the exception of India, advanced, with 16/23 trading days being positive.

MSCI Latin America was the best region surging 14.9%, led by Brazil's 17.8% leap. The currency appreciated 6%. The market continues to relish the prospects of economic and pension reform under newly-elected President Bolsonaro. One of the few losers was Vale, after a tragic breach at one of its mining dams. Colombia was strong, up 13.5%, boosted by crude oil's 15% gain (Brent blend).

The EMEA region improved 10.8%, with all markets in positive territory. Turkey was the leader, surging 18%, boosted by the Central Bank's insistence that it will keep rates high to curtail inflation. Russia's 13.9% improvement can be attributed to crude oil strength which also aided the rouble to appreciate 5.6%. The relative laggards were the Central Eastern European Three (CE3), Poland, Hungary and the Czech Republic, which advanced between 5-7%.

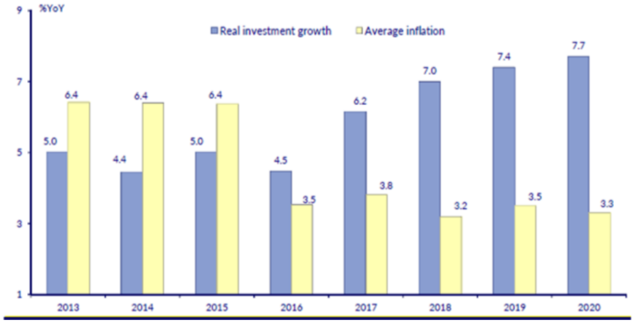
Asia advanced 7.3%, with all markets in the black, except India, which slipped 1.9%. The country faces a general election by May 2019, with markets contemplating a risk to Prime Minister Modi's re-election. Pakistan was the region's best market, jumping 16.4%. It recently concluded an IMF support package. Of the larger country constituents, China's 11.1% accretion is the most significant. The gain was helped by a partial recovery in heavily oversold technology names, such as Tencent and Alibaba.

Consumer Discretionary was the best sector, adding 13.1%. The worst sector was Materials, albeit still up 4.9%.

Indonesia

Both India and Indonesia have elections coming up before the summer this year. Whilst the prospects for Mr Modi in India are muted – the base case is that he will lose his overall majority and be forced to form a coalition to stay in power – Mr Jokowi in Indonesia is widely expected to be comfortably re-elected. The combination of low(er) political risk with a stabilising exchange rate, low inflation and an improving investment cycle makes Indonesia an attractive investment prospect for 2019.

Real investment growth and average inflation



Source: CLSA forecasts for 2019-2020. Source: CLSA, CEIC

Monetary tightening in 2018 was triggered by external factors which had destabilised the balance of payments putting the exchange rate under pressure. There had been no compelling domestic reason to raise interest rates. With external risk subsiding and the exchange rate strengthening, there is no pressure on BI to raise interest rates any further. In the absence of inflationary pressures or further external shocks there is a valid argument for a cut in interest rates which would further boost the market.

We remain positive on selected banks and consumer names.

Romania

In the last weeks of 2018 Romania turned from the ‘dividend darling’ of emerging markets into the ‘government-raided for extra taxes’ victim. The current Romanian government came up with a budget proposal to extract extra taxes from the major industrial players in the country:

1) banks are facing a new banking tax linked to ROBOR rates, labelled as ‘tax on greed’,

2) energy and telecom sectors are facing a 3% tax on turnover; and

3) the capping of gas prices for three years for consumer and industrial users.

It’s not the first time in Romania’s history that the government has tried to extract extra income for its budget (the previous attempt took place in 2013) but what is telling this time is that since the budget announcement in early December, the government hasn’t received a strong rebuke from the European Commission. The EU is visibly quiet on the issue which is a significant change from the previous instances when it took a much more vocal position protecting companies from government attempts to seize profits. One of the possible reasons is that Romania just took up 6-month leadership of the EU Commission. Perhaps Brussels might be more preoccupied with Brexit or Italy’s worries? In any case, this absence of pressure from the EU together with two years of continuous elections in Romania (2019 Presidential and EU Parliament, 2020 Romania Parliamentary and Municipal) raises serious policy uncertainty in Romania in the coming two years. We expect market volatility and the RON to weaken in 2019.

AL, BR & TH