JOHCM Global Emerging Markets Opportunities Fund

EMERGING MARKETS SPOTLIGHT

JULY 2020

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Followers of our process will know that we group our selected country-level market drivers into five broad groups, but that we also recognise that some of these will be more important than others at particular times. We feel that the current environment is one of these times, where pre-existing balance of payments strengths and weakness have outweighed the effects of monetary and liquidity stimulus that are being applied across emerging markets.

When we look at the liquidity and monetary environment in emerging economies, we are focusing on the rate of increase of monetary aggregates and lending/credit in the economy, and assessing how sustainable that is in the light of both inflationary pressures and the degree of leverage in the economy. Generally, faster rates of money/credit creation are supportive of both economic activity and asset prices, with more cyclical industries such as banks and non-bank financials, capital good and autos, and real estate, cement and construction typical beneficiaries.

The response to the Covid-19 crisis in emerging markets has, as in developed markets, involved an aggressive monetary policy response. Rates of money supply increase and bank lending increase are up substantially in many countries, which might normally imply a positive outlook for risk assets in these markets. These are, in many ways, though, exceptional times, and we must act accordingly.

To give a sense of the scale of the change, consider Brazil. Over the last ten years, policy interest rates have averaged 9.6% and consumer price inflation 5.8%, giving an average real policy rate of 3.6%. At the end of June, policy rates had reached 2.25% (down from 14.25% in 2016), with consensus inflation expectations at 2.75% for the next 12 months. Meanwhile, M2 money supply growth reached 23.2% in the year to May 2020, compared to a ten-year average of 10.4%. At first glance, this is a super-bullish environment for equity investors in Brazil.

However, as Keynes noted, monetary policy can, in extreme circumstances, amount to no more than pushing on a string. These are extreme circumstances, and these monetary policy settings have failed to return Brazil to growth. Although real rates are negative and money creation abundant, loan growth has reached a disappointing 9.2% year-on-year (in the 2007 boom, when money supply also grew rapidly, bank lending grew 28.8%). GDP growth in 2020 is predicted to be -6.5%, a forecast that continues to worsen. Similarly, 12-month forecast earnings for the Brazilian equity market (using the Bovespa index) are 36% lower than at the start of 2020.

Brazil is an extreme case, but a similar pattern is seen in other emerging markets where weak current accounts have meant high exposure to external sources of financing that have proved difficult to support during the current crisis. Other markets with sustained current account deficits that have seen high levels of money creation but extremely weak economic outlooks include Mexico, South Africa, Turkey, Indonesia, the Philippines and India. At the same time, those markets with generally strong current accounts have been able to maintain stronger levels of economic growth (and even stronger levels of banking lending growth) from a far less aggressive monetary response – these markets include China, Korea, Taiwan, Malaysia and Thailand. Even in these unprecedented times, the big risk beta in emerging markets remains largely unchanged.

It remains our view that a diversified emerging market equities portfolio needs selected exposure to both groups of countries, even if one group is currently doing better than the other. Whilst we have significant exposure to Korea and China, we also retain exposure to India, where corporate earnings expectations have held up better than in the other countries in the high-risk group, and also to Mexico, which we believe is a high quality market with significant opportunity in more defensive names. Covid-19 is a shocking new development this year, but it is playing out across emerging markets very much along the established lines that we have seen many times before.

JOHCM Global Emerging Markets Opportunities Fund
5 year discrete performance (%)

Discrete 12 month performance (%):

	30.06.20	30.06.19	30.06.18	30.06.17	30.06.16
A USD Class	-6.99	2.23	7.57	26.23	-12.56
Benchmark	-3.25	1.58	7.90	24.13	-12.08
Relative return	-3.87	0.65	-0.31	1.69	-0.54

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in USD, net income reinvested, net of fees as at 30 June 2020. The A USD Class was launched on 30 June 2011. Benchmark: MSCI Emerging Markets NR (12pm adjusted). Performance of other share classes may vary and is available on request.