MAY 2021

JOHCM Funds

EMERGING MARKETS SPOTLIGHT

James Syme
Senior Fund Manager

Paul Wimborne
Senior Fund Manager

- With the pick-up in capital flows to emerging markets, a global recovery, higher commodity prices and the steady roll-out of vaccination, there are some powerful positive drivers for higher-risk commodity-exporting emerging markets.
- However, caution is warranted when navigating the political problems faced by some Latin American countries.

JOHCM Global Emerging Markets Opportunities Fund

Followers of our views will be aware of our significantly more positive tilt towards some Latin American equity markets since the third quarter of last year, with several new names, and increased weightings in Mexico and Brazil. Certainly, Latin America has historically shown a strong relationship between GDP growth and commodity prices, and also between US dollar equity returns and commodity prices.

And, commodity prices remain extremely strong by recent standards. Having started 2020 at around US$100/t, iron ore sits at just below US$200/t; copper has moved from US$2.80/lb to US$4.75/lb; soybeans from US$9.40/bu to US$16.10/bu.

These moves in export prices feed through to commodity-based economies in many ways: trade balances and current account balances strengthen, tax revenue rises, corporate wages and investment can rise. This upward pressure on currencies, corporate earnings and liquidity creates a potentially very attractive opportunity for equity investors like us. Yet, we remain zero weight Argentina, Chile, Colombia and Peru. Why?

In a word, politics. Every unhappy country is unhappy in its own way, so what are the specifics in each of these cases?

Argentina has the least functional politics of the four. The populist government of president Fernandez and vice-president Kirchner has struggled repeatedly with indebtedness (mostly to the IMF), inflation and a weak economy. It has been illegal for companies to fire workers since last year, the private sector is subject to arbitrary price controls (which has caused output to slump), citizens have very limited access to foreign exchange, aggressive wealth taxes are being imposed (with the promise that they are one-offs), and almost every economic statistic is horrendous. Consensus economic forecasts for 2021 are for CPI inflation to be 45% and unemployment to be 11.5%. Until there is the prospect for a change of political leadership, Argentina is effectively uninvestable in our eyes.

Chile has two major political problems. Firstly, president Pinera is highly unpopular and the right-wing coalition he heads seems to be collapsing. This has allowed the opposition to pass several populist bills that are largely seen as negative for the private sector and for financial markets. These include a new mining royalty bill that will be a significant negative for the critically-important mining industry. The bill has been approved by the energy & mining committee in the lower house of parliament and is likely to pass the Senate later this month. The government is unlikely to be able to stop it, given that it similarly failed to stop three bills allowing the public to draw down assets from their private pensions. The unhappiness with the government and with the state of the economy and society has also led to a second important development. In October 2020, following mass protests against inequality, Chileans voted overwhelmingly to replace the constitution, which was implemented during the military rule of General Pinochet. The new constitution will almost certainly create expanded rights to healthcare, education, housing and welfare, and consequently require significantly higher taxation to fund it. It may also constrain the private sector in other ways, and may restructure the relationship between commodity producers and the state. These are not automatically negative outcomes, but the uncertainty clearly creates significant risk for investors.

Unlike Argentina and Chile, the problems in Colombia stem from an attempt by the government to maintain orthodox fiscal policy. Colombia has had an investment grade credit rating since 2011, but the fiscal deficit has expanded from 1.9% of GDP in 2019 to 8.9% last year and an estimated 8.2% this year. Tax revenues have to be increased, with analysts estimating that 1% of GDP in additional revenue is the minimum to maintain the credit rating.

The proposed budget would increase taxes on middle class Colombians, and has proved wildly unpopular. Previous finance minister Alberto Carrasquilla first withdrew the budget, and then resigned, when violent demonstrations broke out across the country, with protesters blocking roads and fighting with the police.

The new finance minister, Jose Manuel Restrepo, has instead sought a national consensus around a budget based on other taxes and spending cuts, but protests have continued. This is also not the first set of violent demonstrations that the Duque government has faced, and the collision between bond markets and the Colombian people makes for a difficult environment for equity investors.

Finally, Peru is in the middle of its presidential election, with the first round taking place in April and the second round taking place on 6 June. Hard left populist Pedro Castillo of the Free Peru Party won the most votes in the first round and is leading in polls ahead of the election runoff. His opponent, conservative candidate Keiko Fujimori of the Popular Force Party is now getting a lot of political support from other right-wing parties, but allegations of corruption, money-laundering and obstruction of justice are weighing heavily on her campaign.

Castillo is a radical, anti-establishment candidate who has said that he does not plan to nationalise private companies in Peru, but who plans an increase in government spending of ten percentage points of GDP, and has hinted at extremely high corporate taxes to help fund this. Current polling suggests a landslide win for Castillo, and the prospect of this is placing significant stress on financial markets.

With the pick-up in capital flows to emerging markets, a global recovery, higher commodity prices and the steady roll-out of vaccination, there are some powerful positive drivers for higher-risk commodity-exporting emerging markets. We are overweight Mexico, Brazil and South Africa in the portfolio, but have avoided the smaller Latin American markets for generally political, but country-specific, reasons.

Source for all data JOHCM/Bloomberg (unless otherwise stated).

An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing or sending any money. This and other important information about the Fund can be found in the Fund's prospectus or summary prospectus, which can be obtained at www.johcm.com or by calling 866-260-9549 or 312-557-5913. Please read the prospectus or summary prospectus carefully before investing. The JOHCM Funds are advised by J O Hambro Capital Management Limited and distributed through FINRA member Foreside Financial Services, LLC. The JOHCM Funds are not FDIC-insured, may lose value, and have no bank guarantee.

Past performance is no guarantee of future results.

RISK CONSIDERATIONS:

Investors should note that investments in foreign securities involve additional risks due to currency fluctuations, economic and political conditions, and differences in financial reporting standards. Smaller company stocks are more volatile and less liquid than larger, more established company securities. The small and mid-cap companies the Fund may invest in may be more vulnerable to adverse business or economic events than larger companies and may be more volatile; the price movements of the Fund's shares may reflect that volatility. Fixed income securities will increase or decrease in value based on changes in interest rates. If rates increase, the value of the Fund's fixed income securities generally declines. Other risks may include and not limited to hedging strategies, derivatives and commodities.

The views expressed are those of the portfolio manager as of May 2021, are subject to change, and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice.