J O Hambro Capital Management Group

Emerging Markets Spotlight

James Syme, JOHCM Global Emerging Markets Opportunities Fund

"Beyond 2019, the aggregate growth rate for the group reflects offsetting developments as growth moderates to a sustainable pace in China, while it improves in India, owing to structural reforms and a still-favorable demographic dividend" IMF World Economic Outlook, October 2018

We were recently asked for an update on our bullish thesis for Indian equities, and we wanted to share a shortened version of that thesis. (Please contact your representative at the firm if you would like the expanded version.)

We have an interest in the markets in countries where GDP growth is expected to be the highest over the medium term. The IMF's forecasts in October's World Economic Outlook identify India as the fastest growing of the 24 emerging markets in the MSCI EM benchmark, with the 2019-23 real GDP growth forecast to average 7.8% (compared to China at 5.9%, Brazil at 2.3% and a GDP-weighted average for the EM country universe of 4.6%). Real GDP growth averaged 7.7% in the first three quarters of 2018, while other indicators of economic activity have also been strong. Yet inflation remains benign (3.3% latest), which combines with the current account balance to suggest that this strong level is, for now, sustainable.

On top of this, we are particularly positive on India because of the broad de-leveraging that has occurred there in the last 10 years. Since 2008, easy global monetary policies have driven strong credit growth in most of the emerging world, and investors have enjoyed the benefits of this (remember the 'EM consumer' enthusiasm of 2010-14?), but not in India. Since 2008, private non-financial sector credit has grown by 17.1% of GDP in Brazil, by 97.3% of GDP in China, by 29.7% of GDP in Korea, but only by 1.7% of GDP in India. This leaves India as the only major economy in the world with low levels of leverage and no recent credit growth, which underpins the potential for domestic demand in particular. Further, the credit growth we have been looking for is coming through. Non-food credit grew by 13.4% year-on-year in October 2018.

Over the longer-term, the other driver of nominal US dollar GDP growth is currency valuation. Although India runs a current account deficit (forecast at 2.5% of GDP in 2019), the IMF's assessment is that the current real effective exchange rate of the rupee is 'broadly consistent' with the country's economic fundamentals, noting that, at this stage of its economic development, India should run a structural current account deficit of 2.3% of GDP.

The Indian equity market is expensive on an absolute basis (18.1x 12mf P/E ratio for MSCI India), but strong forward growth still leaves upside (forward earnings growth is forecast at nearly 20% p.a.). In addition, India has always traded at a significant premium to EM. That premium looks stretched at present, whilst growth prospects also look stronger, making valuation in the context of the asset class neutral.

India is our favorite market at this time, as we see both a strong trend growth rate as well as the potential for a cyclical recovery in the context of sustainable inflation and current account dynamics. Whilst Indian equities are not cheap in an absolute sense, we feel that growth opportunity and the prospects for further reforms justify current valuations. Within India, our investments are focused on domestic cyclicals, including private sector banks, consumption and industrials.

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

Discrete 12-month performance to:

	30.11.2018	30.11.2017	30.11.2016	30.11.2015	30.11.2014
A USD class	-9.48	36.76	2.70	-10.16	3.83
Benchmark	-9.34	33.34	7.95	-16.92	1.64
Relative return	-0.16	2.56	-4.86	8.14	2.15

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 November 2018. Inception date: 30 June 2011. Note: All fund performance is shown against the MSCI Emerging Markets Index (12pm adjusted). Performance of other share classes may vary and is available upon request.