February 2019

FOR PROFESSIONAL INVESTORS ONLY

J O Hambro Capital Management Group

# Emerging Markets Spotlight

## James Syme, JOHCM Global Emerging Markets Opportunities Fund

There are two powerful sources of qualitative information that can help investors in emerging markets assess how US monetary policy (which is one of the key global drivers of EM equity returns) might evolve.

The first of these two is the quarterly results and outlook commentary from globally-facing US companies. These comments give an immediate view of the state of demand in various economies around the world, and how those demand conditions might be feeding back into the US economy (and, in turn, how US monetary policy might evolve). The second is from speeches and comments from the leadership of the Federal Reserve, particularly where those comments reference emerging markets.

It has been our view for over a year that the G7 policy-driven slowdown in emerging economies would feed back into the developed world through weaker orders and revenues for EM-facing companies, until either weakness in financial markets and/or weakness in economic statistics caused a policy re-think in G7 capitals. Over the last 20 years, sustained weakness in emerging market currencies has led, or been coincident with, a fall in US and G7 activity measures, such as industrial production and manufacturing PMI. We expect the EM sell-off in 2018 will show up in developed market corporate and economic data in 2019.

Looking at some of the company results published so far in 2019, there are certainly signs of weakness, with China very much a focus of it. This trend includes Apple ('while we anticipated some challenges in key emerging markets, we did not foresee the magnitude of the economic deceleration, particularly in Greater China. In fact, most of our revenue shortfall to our guidance, and over 100 percent of our year-over-year worldwide revenue decline, occurred in Greater China'), Caterpillar ('Construction activities remained at low levels in Latin America... weakness in the Middle East… sales in Asia/Pacific declined due to lower demand in China'), Nvidia ('deteriorating macroeconomic conditions, particularly in China') and Disney, where a trend of very strong results from parks and resorts was broken by 'lower operating income at Shanghai Disney Resort… primarily due to lower attendance').

We can also see the Federal Reserve paying increasing attention to emerging markets. Notably, Chairman Jerome Powell held the view in May 2018 that 'the normalization of monetary policies in advanced economies should continue to prove manageable for EMEs', but by September 2018 was recognising that 'when our economy is strong and we're raising rates, that puts upward pressure around the world and can affect countries, particularly countries that have external dollar borrowing… The performance of the emerging market economies really matters to us in carrying out our domestic mandate', which pre-figured the recent move to the Fed being 'patient' with rate hikes.

This growing evidence of weakness in the cyclical part of EM does not create an automatically bearish outlook for the asset class though. One of the key sensitivities in the asset class is to bond yields and the strength of the US dollar; markets more exposed to this tend to be the more domestically-driven, current account deficit markets such as India, Indonesia, Turkey and most of Latin America. As US monetary policy moves through the stages of fewer hikes-pause-cuts-[QE4?], the prospects for economic growth and market recovery in these markets improve. We expect strong returns from some of these markets in 2019, and have seen a strong start to the year in some of them. In addition, the more cyclical end of EM (predominantly Asian exporters) does contain some markets that are clearly already pricing in a sharp slowdown – we would highlight the strong performance (+21.7% at the time of writing) of Samsung Electronics since its 'disappointing' results on 8 January as an example of a stock already pricing in the worst. We remain substantially overweight India and Korea and continue to rotate the portfolio into more domestically-driven markets that can benefit from the Fed's new-found caution.

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

Discrete 12-month performance to:

| | 31.01.2019 | 31.01.2018 | 31.01.2017 | 31.01.2016 | 31.01.2015 |
|---|---|---|---|---|---|
| A GBP class | -5.25 | 20.38 | 42.24 | -17.00 | 21.76 |
| Benchmark | -7.60 | 23.92 | 45.49 | -17.74 | 15.89 |
| Relative return | 2.54 | -2.86 | -2.23 | 0.89 | 5.06 |

**Past performance is no guarantee of future performance.**

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in GBP, net income reinvested, net of fees, as at 31 January 2019. 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.

**Past performance is no guarantee of future performance.**

The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Investing in companies in emerging markets involves higher risk than investing in established economies or securities markets. Emerging Markets may have less stable legal and political systems, which could affect the safe-keeping or value of assets. The Fund's investments include shares in small-cap companies and these tend to be traded less frequently and in lower volumes than larger companies making them potentially less liquid and more volatile. The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation. Issued and approved in the UK by J O Hambro Capital Management Limited, which is authorised and regulated by the Financial Conduct Authority. JOHCM® is a registered trademark of J O Hambro Capital Management Ltd. J O Hambro® is a registered trademark of Barnham Broom Holdings Ltd. Registered in England and Wales under No: 2176004. Registered address: Level 3, 1 St James's Market, London SW1Y 4AH, United Kingdom.