J O Hambro Capital Management Group

Emerging Markets Spotlight

James Syme, JOHCM Global Emerging Markets Opportunities Fund

"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." – Apple Q4 2018 results commentary

Since the middle of 2018 we have been expecting US corporate results to reflect the broad slowdown in many emerging markets (including China), and Apple has very much met our expectations with its latest quarterly commentary. At the same time, however, there has been much media commentary about various stimulus policies being enacted in China, creating mixed news flow regarding the economic outlook in China.

As a starting caveat, we feel that Apple may be overstating the degree to which the Chinese economy is the cause of its disappointing results. Market share data has shown strong growth in Chinese smartphone sales by local producers, particularly Huawei, while Apple has struggled. This is because the dominance of integrated multi-purpose platforms (WeChat, Taobao) which reduce the costs of switching from iOS to Android for Chinese users. As always, it is important not to read too much into a single data point and explanation.

However, there is plenty of other evidence of a deep slowdown in China. In the first nine months of 2018, domestic consumption tax revenues averaged RMB109.8bn per month, but October saw revenues of RMB32.1bn and November only RMB17.0bn. Car sales in October were down 13.0% on a year earlier. More industry-linked measures (e.g. rail freight turnover, cement consumption) look healthier but the trend is certainly down. Finally, stock markets are not economic data, but the Shanghai SE Composite index fell 28.7% in US dollar terms in 2018, reflecting negative domestic investor sentiment.

None of this particularly surprises us. We believe that China remains an essentially domestically-driven economy (exports/GDP is about 20%, compared with, for example, 40% for South Korea; this also, we feel, makes concerns about the impact of tariffs overstated), and that growth in domestic demand (and, resultantly, economic growth) is substantially driven by the change in credit. That change in credit has been slowing since 2016 and increasingly hurting the wider economy.

Following the stimulus in 2015, the year-on-year growth in the financial system (we track all-system claims, including shadow banking products such as bankers' acceptances and trust loans) peaked at +22.2% in the year to January 2016, but that growth rate has steadily declined. The increase to November 2018 was only 8.0%; with real GDP growth for the year estimated at 6.6% and the latest CPI print of 2.2%, credit is now growing more slowly than the economy. This negative credit impulse is a significant drag on economic activity in China, and a very different environment to that which has existed since the renminbi was floated in 2005.

Various stimulus packages have been announced, with an alphabet soup of lending programmes from the People's Bank of China (SLF, MLF and PSL were recently joined by TMLF). However. the reality, as seen in the data that we believe matters, is that monetary policy in China is tight, fiscal policy is broadly neutral, and there is no immediate reason to expect a turnaround in the economy. We remain cautious on Chinese equities (especially A-shares, where we remain zero- weighted), cautious on commodities and commodity economies, and continue to expect disappointment from global companies that sell into China. At some point, probably given the weakening renminbi, Chinese policy will turn more stimulative, but we believe it will pay to wait until that turn is tangible.

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

Discrete 12-month performance to:

	31.12.2018	31.12.2017	31.12.2016	31.12.2015	31.12.2014
A GBP class	-9.82	28.23	26.34	-4.41	6.23
Benchmark	-9.57	25.15	34.03	-10.61	3.74
Relative return	-0.28	2.46	-5.74	6.94	2.40

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 December 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.