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FOR PROFESSIONAL INVESTORS ONLY

Emerging Markets Spotlight

James Syme, JOHCM Global Emerging Markets Opportunities Fund

“US consumer staples plunge as bond yields rise”

Financial Times, 24 May 2018

We wrote last month about the negative effect of rising US bond yields on some emerging economies (and their currencies). The sharp sell-offs in Argentina and Turkey in May support our views, but there are also some key sector effects in this environment.

So far 2018 has seen ample evidence of a strong global growth environment, but with gently building inflationary pressures putting upward pressure on bond yields. From a starting level of 2.4%, US 10-year Treasury yields reached 3.1% in mid-May. The increase in risk-free bond yields puts pressure on other income-generating assets around the world, including emerging market bonds, but also including low-beta, dividend-paying stocks, the so-called ‘bond proxies’. These stocks, principally in the consumer staples, telecom and utilities sectors, have generally performed well in recent years, but now face a less favourable environment.

This has been the case in emerging markets year-to-date. With the MSCI Emerging Markets price index down 1.0%, MSCI EM indices for consumer staples, telecoms and utilities are down 3.2%, down 9.8% and up 1.5% respectively. The portfolio is significantly overweight consumer staples (in India, Mexico and Russia, which provide exposure to domestic demand; in South Korea, China and Brazil as more defensive positions), and broadly neutrally-weighted in telecoms and utilities.

The consumer staples position has been a negative contributor to the portfolio’s performance year-to-date, but within the sector there has been a broad range of returns. The investments with exposure to China included Tingyi (noodles) and South Korea’s LG Household & Health (cosmetics), which have both performed well after a strong 2017, and also Hengan International (infant care), which has lagged year-to-date, also after a strong 2017. We see continued strong growth in the Chinese consumer sector in 2018, despite monetary tightening, with companies with strong brands able to push through earnings-enhancing average-selling price increases in 2018. Also generating positive performance despite a weak country performance has been retailer Walmart de Mexico (Walmex).

India’s ITC (tobacco) and Russia’s Lenta (retail) are about flat year-to-date. Both countries are seeing a pick-up in economic growth, but the higher oil price is a tailwind for the Russian consumer and a headwind for the Indian consumer. Tax increases have also been a drag on ITC’s operational performance. Also in Russia,

retailer Magnit has been weak this year, as investors wait to see the effects in a change of corporate leadership.

The bulk of our underperformance in consumer staples has come from Brazilian food producer BRF, which has underperformed even a generally weak Brazilian equity market. It has struggled to maintain margins despite lower input prices and the weakness in the Brazilian real. As at Magnit, there has been a change in management, the effects of which are yet to be seen.

Nonetheless, the positive contribution of telecoms and utilities has more than offset the drag on performance from consumer staples. In each case we have a single Chinese holding. China Mobile reported impressive 2017 results but declined slightly, in line with the MSCI EM Telecoms index, but our utility investment, ENN Energy, performed very strongly (+46.3% in US dollar terms), on continued strong demand for natural gas in Chinese urban areas.

Overall, the portfolio has seen a positive contribution from its investments in bond proxies. Whilst some of this came from good top-down calls, it was principally through stock selection. Our process remains assertively top-down, but stock selection also remains a key part of the process, as can be seen in this case.

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

Discrete 12 month performance to					
	31.05.2018	31.05.2017	31.05.2016	31.05.2015	31.05.2014
A GBP Class	8.33	47.35	-16.02	17.36	-1.93

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 31 March 2018. Inception date: 16 June 2008. Note: All fund performance is shown against the MSCI Emerging Markets (12pm adjusted). Performance of other share classes may vary and is available upon request.

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