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FOR PROFESSIONAL INVESTORS ONLY

Emerging Markets Spotlight

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It has long been generally thought to be the case that two of the key drivers of the relative performance of EM equities versus developed world equities are the growth differential between emerging economies and developed economies, and the strength of the US dollar against other global currencies. These relationships can be made more meaningful by excluding China from the EM component of this model (for complicated reasons to do with China's closed capital account, and more simple reasons to do with the quality of China's GDP growth statistics).

Supporting this, JP Morgan has published research showing a fairly strong regression relationship between EM vs. DM growth differentials, the move in USD/EUR and capital flows to emerging markets (ex-China). Its research concludes: 'robustness tests run with a diverse set of external and domestic variables regularly show EM-DM growth differentials and US dollar performance to be dominant drivers of capital flows.'

With this in hand, how do prospects stack up for the rest of 2019 and into 2020?

The good news is that conditions for EM ex-China look better for the next few years than they have in recent years. During the 'golden years' of 2002-12, when the MSCI Emerging Markets index substantially outperformed the MSCI World index, EM ex-China (GDP-weighted) had average GDP growth of 4.6% p.a., 3.2 per cent faster than the developed world (source: IMF, for all GDP data here). The difficult period for EM in relative performance terms was 2013-2018, when the EM ex-China relative GDP growth gap was only 1.2 per cent. Using IMF forecasts from April's World Economic Outlook database, EM ex-China should grow at 3.7% p.a. from 2020-23, 2.3 per cent faster than the developed world. This should support EM equity outperformance over the next few years.

Looking into what is driving this, two trends appear. The first is the key role of a few Asian economies in driving EM ex-Chinese GDP growth. India is the largest ex-China EM economy (2019 GDP: US\$3 trillion) and is the fastest growing (2020-2024 average GDP growth forecast 7.7%), and the combination of these two means that India is expected to represent 35% of the total growth in EM GDP outside of China. As such, India is a key opportunity for EM equity investors, despite not being among the very largest markets by index weight). Smaller, but also key, are Indonesia (US\$1.1 trillion; 5.3%) and Korea (US\$1.7 trillion; 2.9%). Other markets are mostly too small

(e.g. the Philippines, Egypt) or too slow growing (e.g. Russia, South Africa) to make a big contribution. Brazil is perhaps the one that might also make a big contribution, although regular followers will be aware of our concerns regarding the success or otherwise of social security reform there.

It should be noted, also, that the IMF forecast a steady slowing of Chinese GDP growth down to 5.6% in 2023, which will act as a headwind to wider EM growth. Whilst that fits with our shorter-term expectations, any successful stimulus policy in China should lift the EM relative growth gap, improving the outlook for equity investors.

So, a positive growth outlook, but a note of caution is the other half of the global macro environment: the US dollar. Whilst we are not G7 currency experts, one trend in the IMF's forecasts is that the US has had the largest increase in forecast 2020-23 GDP growth of any of the developed markets, which might point to renewed US dollar strength in the future. That would then put focus on inflation, current account balances and other macro-drivers of individual EM equity markets, which is why our process also looks not just at growth, but also the sustainability of that growth.

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

Discrete 12-month performance to:

	30.04.2019	30.04.2018	30.04.2017	30.04.2016	30.04.2015
A GBP class	1.72	12.36	38.95	-16.49	27.52
Benchmark	0.16	14.81	34.67	-13.54	17.84
Relative return	1.56	-2.13	3.18	-3.41	8.22

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 30 April 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.

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