JOHCM Funds

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Emerging Markets Spotlight

Many large emerging markets display a high sensitivity to global risk appetite, and the asset class is often thought of as a barometer of investor sentiment. This can overlook the substantial exposure of some emerging markets to the strength of the global economy, and the visibility into aggregate demand that these markets can provide. In recent economic data prints from these countries we think there are some very concerning signs.

The first and most important set of countries are the two big East Asian export economies of South Korea and Taiwan. As exporters of electronic goods, vehicles, and chemicals, as well as being providers of airborne and seaborne freight services, these two countries are highly sensitive to the global economic cycle (as investment grade borrowers with large and sustained current account surpluses they have much less sensitivity to risk appetite). The single most disturbing data point is Taiwan's July Purchasing Managers' Index (PMI) print of 44.6, showing a rapid deterioration in business expectations (figures above 50 indicate positive expectations; below 50 show negative expectations). Further, South Korean manufacturing PMI for July was 49.8 (the lowest since 2020), South Korean earnings expectations have been drifting lower since they peaked in September 2021, and Taiwanese earnings expectations may also now be declining.

Things look worse in the European export economies of Central Europe. Poland shows signs of an accelerating slowdown, with manufacturing PMI 42.1 in July, fully 10 points lower than in April. There is a similar story in the Czech Republic with July PMI down to 46.8 and consumer and business confidence dipping lower. Given collapsing business expectations in the regional heavyweight economy in Germany, these are not a surprise, but they add to a picture of global demand being in trouble.

The third major cyclical exporter is Mexico. Mexico has complicated business survey data, with two separate time series. For July the Mexican manufacturing and non-manufacturing PMI surveys were both 52.2, showing expansion, but the S&P manufacturing PMI survey came in at 48.5, indicating contraction. Given the much better net energy trade position of North America compared with Europe and Asia, it may be that Mexico fares much better, and we remain positive on the market.

Another market which we are positive on but where survey data has weakened recently is South Africa, where the July manufacturing PMI dropped to 47.6, even if vehicle sales and credit growth remain robust. We continue to think that very strong commodity exports will support aggregate demand in South Africa, but economic data there will need careful monitoring.

Followers of our views will know that we consistently express the view that the opportunity within emerging markets is more reliable than the opportunity of emerging markets. There are always economies and markets in upswings, and the current environment is no different. The same commodity export story that is supporting Mexico and South Africa is coming through very strongly elsewhere. In Brazil the services PMI for July reached the incredibly strong level of 60.8, a new high, indicating a full-blown domestic demand boom underway. Brazilian earnings estimates have also been rising as strong corporate results come through. Indonesian GDP growth is expected to exceed 5%, with the July manufacturing PMI at 51.3 and consumer confidence very strong. Finally in the Gulf, high oil prices are driving intense economic upswings. July PMI survey data for the UAE (one of our preferred markets) was 55.4, while in neighboring Saudi Arabia it reached 56.3, with Saudi GDP growth for Q2 of 11.8% YoY.

Higher commodity prices act as drags on most global economies, while the strong dollar and higher interest rates are further headwinds. Right now, many commodity economies are seeing strong growth that is hard to find anywhere else in the world, and we believe this will attract increased interest from global investors. We remain overweight Mexico, Brazil, South Africa, Indonesia and the UAE.

Source for all data JOHCM/Bloomberg (unless otherwise stated)