J O Hambro Capital Management Group

News

Leading and Lagging the Emerging Market Index

Recent moves within the asset class reveal interesting patterns that may point to potential risk opportunities

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Followers of our strategy will know that we focus far more on the opportunity within emerging markets than on the opportunity of emerging markets. So, when the asset class moves sharply higher, as in the last three months, we will be looking at which markets are leading the emerging market index higher, which are lagging, and why. Doing that analysis on the recent move reveals, we think, some interesting patterns that point to potential risk and opportunity later in the year.

First, the facts. The MSCI EM Index returned +22.2% in USD terms from the end of October 2022 to the end of January 2023. The undisputed leader was MSCI China, returning +52.5% in USD terms. Some smaller European markets also performed well, but the next best major markets were Taiwan (+30.2%) and Korea (+22.5%). India returned -3.5%, while in Southeast Asia, Thailand (+19.1%) led and Indonesia (-0.8%) lagged. Major Latin America pair Mexico (+15.6%) and Brazil (+0.8%) lagged, but the weakest major markets were in the Arab world, with UAE returning -9.3% and Saudi Arabia -8.3%.

Some of those moves make sense. In China, two years of relentlessly negative economic and political developments ended with a swift move to reopen the economy and prioritise economic growth. An equity market that had derated on negative sentiment and a weak outlook reacted very strongly. Nevertheless, we remain broadly neutral China as we feel that the impact of rising Covid cases on the economy has yet to be considered by investors.

At the other end, the decline in the oil price to around $80 per barrel, as well as monetary tightening imported from the US, has weakened the outlook for the Arabian Gulf economies, while equities in

Saudi Arabia looked expensive against emerging market peers, all of which have justified the move lower. However, we feel that some other market moves in the last three months do not reflect underlying fundamentals. In particular, the strength of equity markets in Korea and Taiwan, and the relative weakness in India and Indonesia, does not match the underlying developments in those economies. Exports from Korea and Taiwan have been notably weak (-16.6% and -21.2% in the year to January, respectively). That has led to weak industrial production and PMI surveys showing economic contraction.

Significantly for equities, in the three months to January, the twelve-month forward consensus estimates of corporate earnings fell 12.5% for the Korean KOSPI index and 11.8% for the Taiwanese TWSE index, reflecting ongoing weakness in company results (local indices have been used as they are stated in local currency terms). Meanwhile, India and Indonesia continue to show signs of ongoing economic recovery. Healthy GDP and industrial production data for India aligns with strong PMI surveys and company results and a 3.1% increase in the twelvemonth forward consensus estimates of corporate earnings for India's Sensex index in the three months to January.

Similarly, Indonesia has seen surveys indicating a robust economy, excellent company results (particularly in the consumer sector), a strong GDP growth number and a 6.9% increase in the twelve-month forward consensus estimates of corporate earnings for Indonesia's JCI index in the three months to January. Korea and Taiwan have performed well, but we feel this is more of a technical bounce from very weak levels than any sustainable market recovery driven by supportive economic fundamentals. They are also the markets least likely to be supported by the weaker dollar and stronger capital flows to emerging markets that the period in question has seen. We very much believe that more traditional emerging markets, including India and Indonesia, remain better positioned for this year and remain overweight India and Indonesia and underweight Korea and Taiwan.

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

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