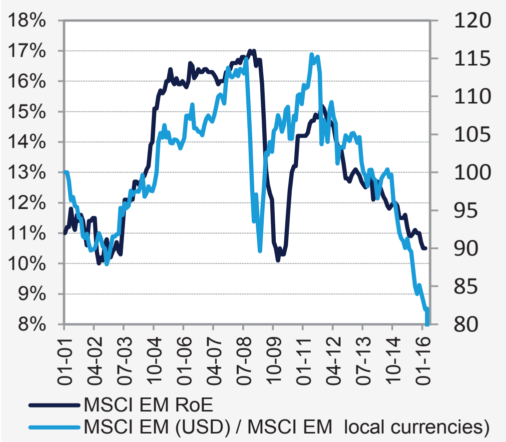
Weak investor exposure may point to a rally. Low valuations would suggest long-term potential. But conditions are not yet right to have a strong conviction on a rapid return of profits.

Of course, the markets will price this in and forex market trends should provide us with precious data. A divergence occurred in 2014 (falling currencies and rising share prices). Equities ultimately turned around and followed currencies downward. If this trend were to continue, this time upward with exchange rates, that would be a good sign, especially as currencies have faithfully anticipated RoE trends both upward and downward since the start of the 2000s.

3 MSCI EM: RoE and FX



Source : Datastream, Amundi Research

Conclusion

Emerging markets have held up well so far this year. The stabilisation of oil prices and the topping off of the dollar have been powerful catalysts, especially as these markets – both currencies and equities – were oversold and inexpensive. However, economic fundamentals remain very shaky and caution is still in order. The rebalancing of the Chinese economy towards more consumption is a slow process and corporate deleveraging has only just begun.

That said, cyclical recoveries begin always with tactical rallies, during which it is better not to be underweight. For this tactical rally to turn into a cyclical rally several conditions must be met:

- China's economy will have to continue to stabilise, given its influence over other emerging economies;
- Oil and industrial commodities will also have to continue to rally;
- The renminbi will have to remain stable;
- The US dollar must not rise too much, even when the Fed raises interest rates.

If these conditions are met, emerging markets could well be the positive surprise of 2016.

"Emerging markets could well be the positive surprise of 2016"

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Cross asset investment strategy

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