



October 2021
Emerging Markets Charts & Views
Why EM could be back in focus in 2022

Investment Insights | Market Stories

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ASSET MANAGEMENT

EM ready for a comeback, but volatility will remain high



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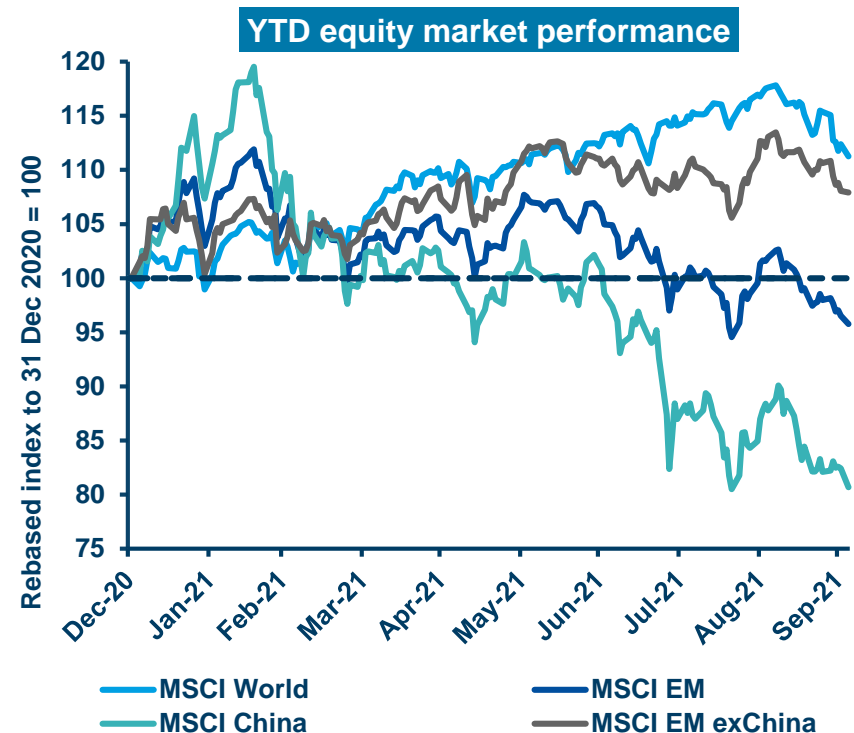
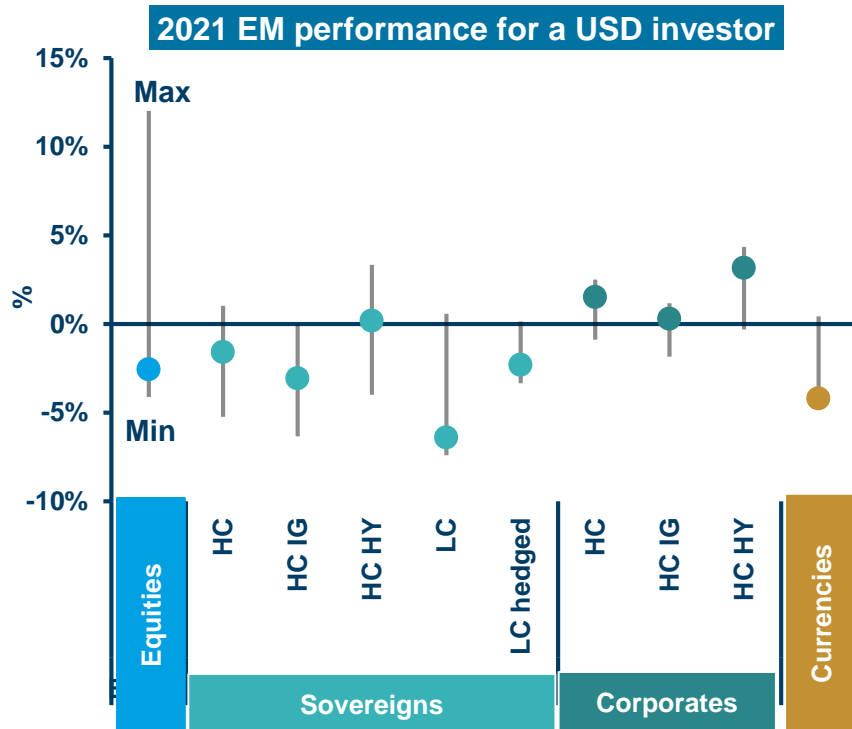
“ Emerging markets (EM) performance has been held back over the first three quarters of 2021 by a few factors, including the spread of the Delta virus variant in less vaccinated countries, news out of China (growth slowdown, regulation crackdown, and the housing slowdown alongside the Evergrande fallout), and the upcoming Fed tapering. Although some idiosyncratic risks remain and uncertainty is high, **we believe that most of the bad news is behind us. As such, EM should manage the current situation and they are better positioned to do so than they were in 2013, when the Fed first tapered its purchase programmes. A few elements support our view:**

- the peak of the Delta variant is behind us;
- the vaccine rollout has speeded up in low-income countries;
- the Fed’s tapering will be gradual, with likely limited impact on global financial conditions;
- the EM-DM growth gap should widen in favour of EM; and
- China’s policy stance is becoming more accommodative to avoid a hard landing.

In 2022, investors could play EM opportunities in different ways. With global yields at historic low levels, **EM debt is an income source.** Inflation should be less of a concern for hard currency (HC) bonds, while – in the local currency (LC) space -- our conviction is with countries where the tightening cycles are almost complete. Other segments may also be considered, such as corporate and green bonds, as the green transition will accelerate further in the coming years. We are keeping a neutral view on EM currencies due to the poor risk reward at this stage.

EM equity offers good value in terms of relative valuations in a global context, with room for a catch-up. Global investors’ positioning is light. As EM are a heterogeneous pool, **investors should be selective, active, and flexible**, while monitoring two main global risks: growth and inflation trends. China could face additional regulatory constraints, but **we remain constructive on Chinese assets in the long term for structural reasons. India could benefit from China’s slowdown and it is a bright spot within Asia.**”

Scattered YTD performance for EM assets

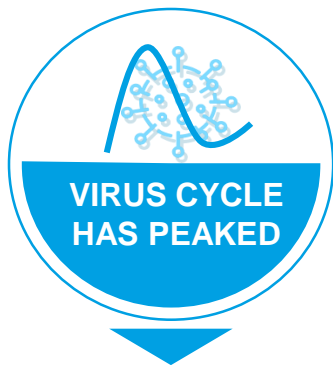


➤ After a strong rebound in the second part of 2020, EM assets have suffered some headwinds (rising US Treasury yields, idiosyncratic stories). HC bonds have outperformed LC debt, where HY space is the bright spot, while the weakening of EM currencies has affected LC bonds. China equity weighs on some EM indices, registering mixed YTD returns, generally showing weaker performances than DM.

Source: Amundi, Bloomberg. Data is as of 4 October 2021. **Past performance is no guarantee of future results.** HC: hard currency. LC: local currency.

Source: Amundi, Bloomberg. Data is as of 5 October 2021. Indexes are rebased as of 31 December 2020=100. Data refers to MSCI indexes and all indexes are measured in dollars. **Past performance is no guarantee of future results.**

Main reasons for a constructive view on EM



Spread of the Delta variant has peaked in many countries. Vaccine rollout is progressing at an uneven pace, with some EM progressing steadily, while others are experiencing more difficulties.



Following a robust economic recovery in the first half of 2021, DM growth momentum is expected to slow. As such, the DM-EM growth gap should narrow in favour of EM over the next few months, once the situation in China stabilises.



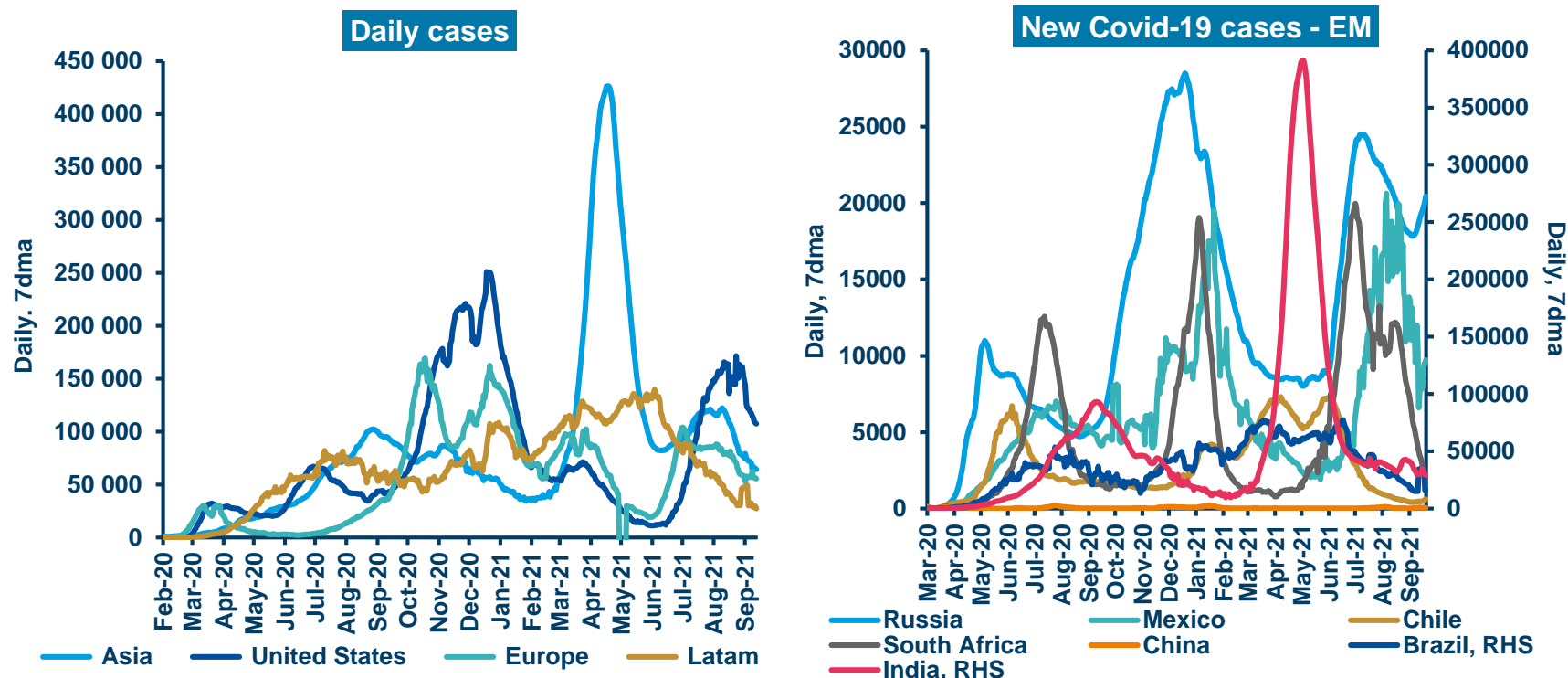
China's regulation crackdown has hit some sectors, adding uncertainty to the economic outlook, possibly impairing a few EM. On the other hand, financial markets could shift from perceiving such a slowdown as a headwind for risky assets to viewing the possible easing as a tailwind.



Inflation has been accelerating globally and some EM CB have been hiking rates. Some EM are still normalising their monetary policy, while other CB are closer to the end of their tightening cycles and we could see more supportive policy going forward.

Source: Amundi as of 24 September. DM: developed markets. EM: emerging markets.

EM Covid-19 contagion peak is likely behind us

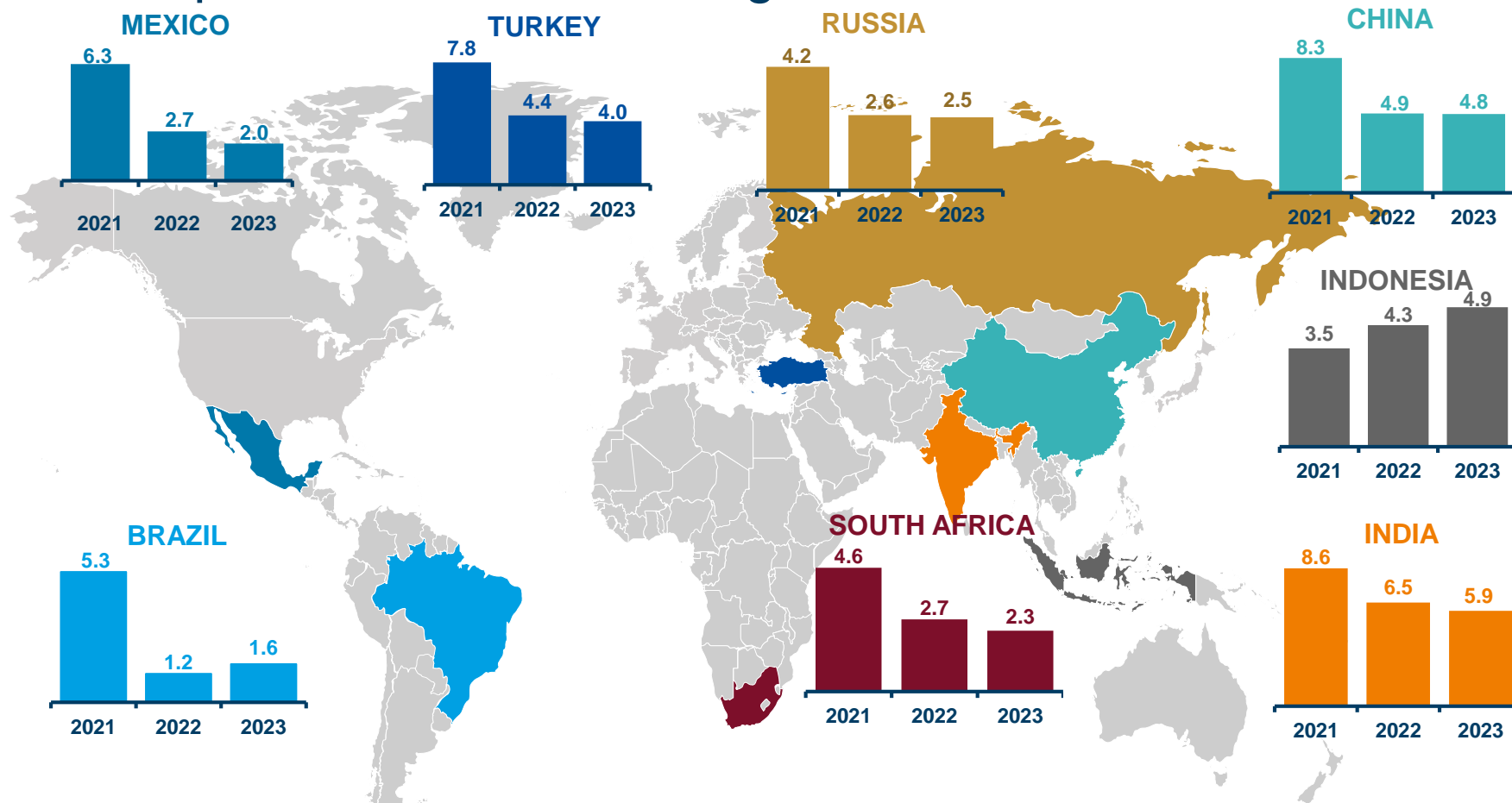


» The Delta Covid-19 variant has caused a resurgence of cases around the world, but currently EM are generally better placed than DM. The situation is generally improving across EM, except for Russia and Mexico where cases are on the rise. China has reported new cases transmitted locally and has reintroduced containment measures amid a zero-tolerance policy. This has caused an economic slowdown over the summer.

Source: Amundi elaborations on Bloomberg data as of 3 October 2021. 7dma: seven-day moving average. France recomputed the number of cases on 20 May 2021, affecting the total number of cases for Europe.

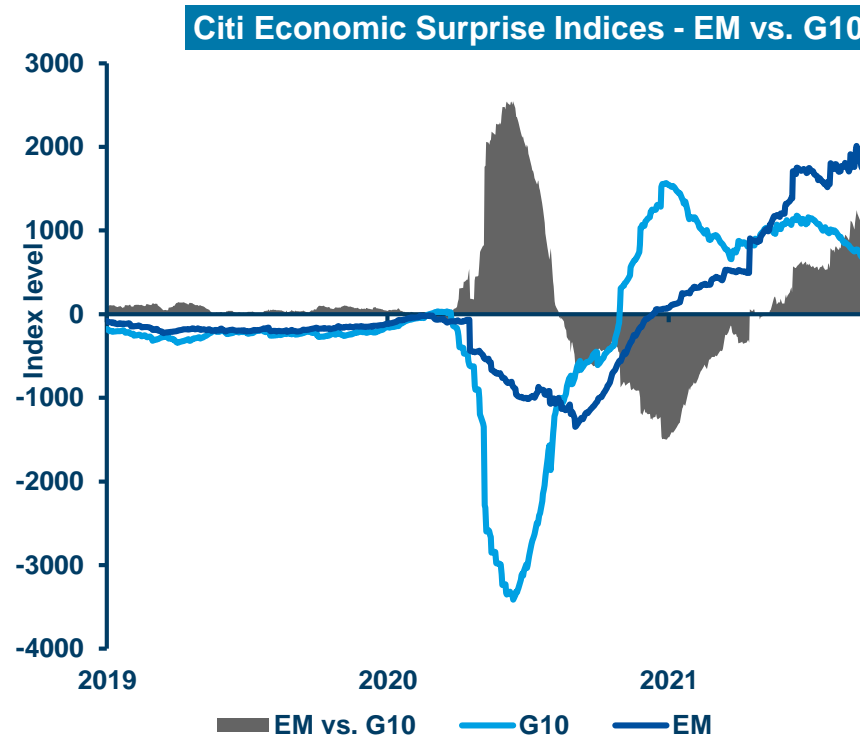
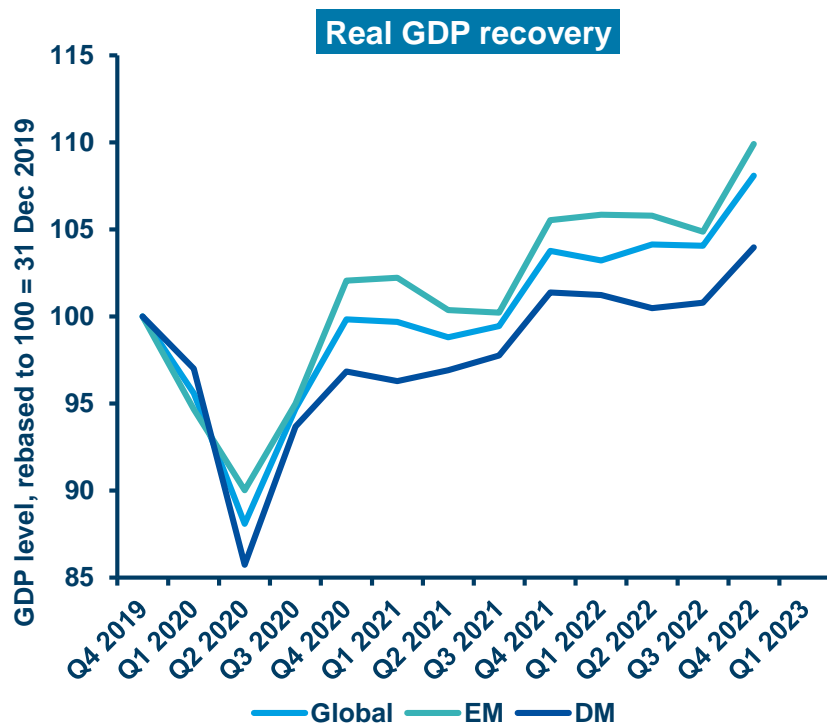
Source: Amundi elaborations on Bloomberg data as of 27 September 2021. 7dma: seven-day moving average.

Growth remains healthy across EM, normalising from 2021 peak, with China being the main area of attention



Source: Amundi Research. Latest forecasts are as of 28 September 2021. Bars represent real GDP growth (YoY%) forecasts.

Momentum is slowing down globally, less so in EM

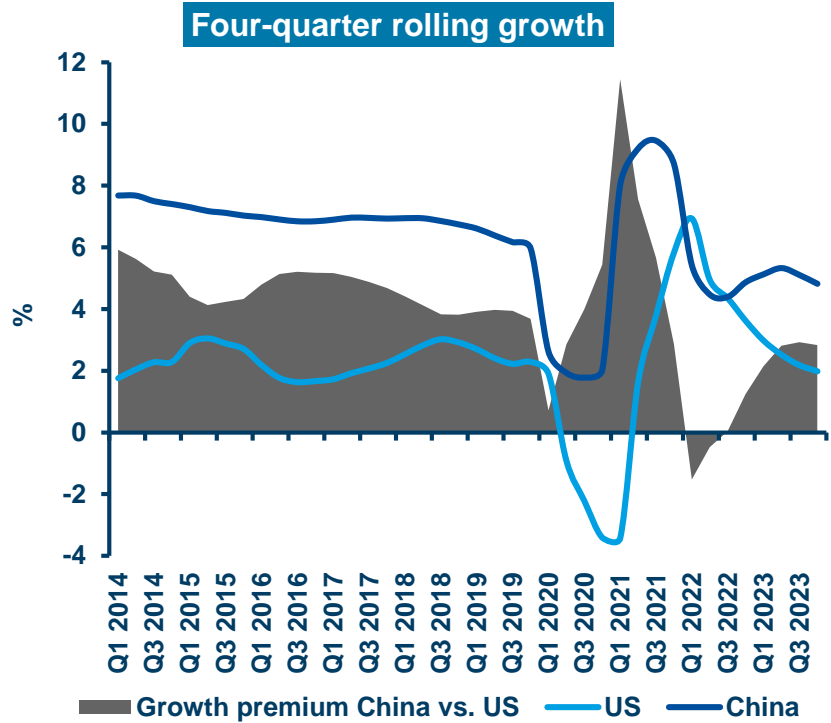
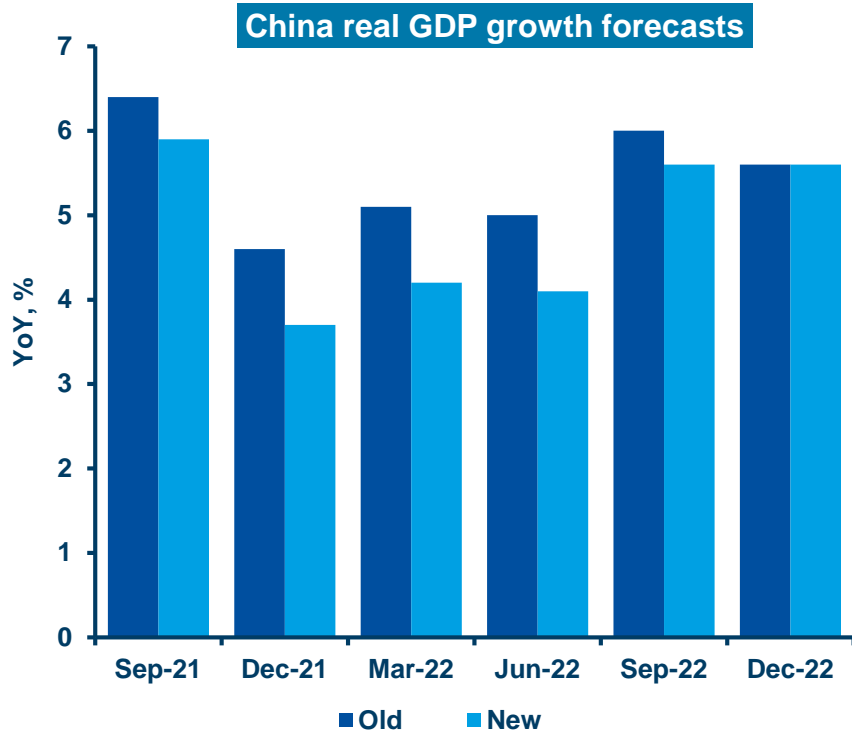


» Growth momentum has slowed due to the Delta variant outbreak. However, the growth premium has turned in favour of EM, showing a multi-speed rebound across EM, with LatAm and Eastern Europe outperforming Asia.

Source: Amundi Research. Data is as 6 October 2021.

Source: Amundi, Bloomberg. Data is as of 21 September 2021.

China's growth outlook has been downgraded

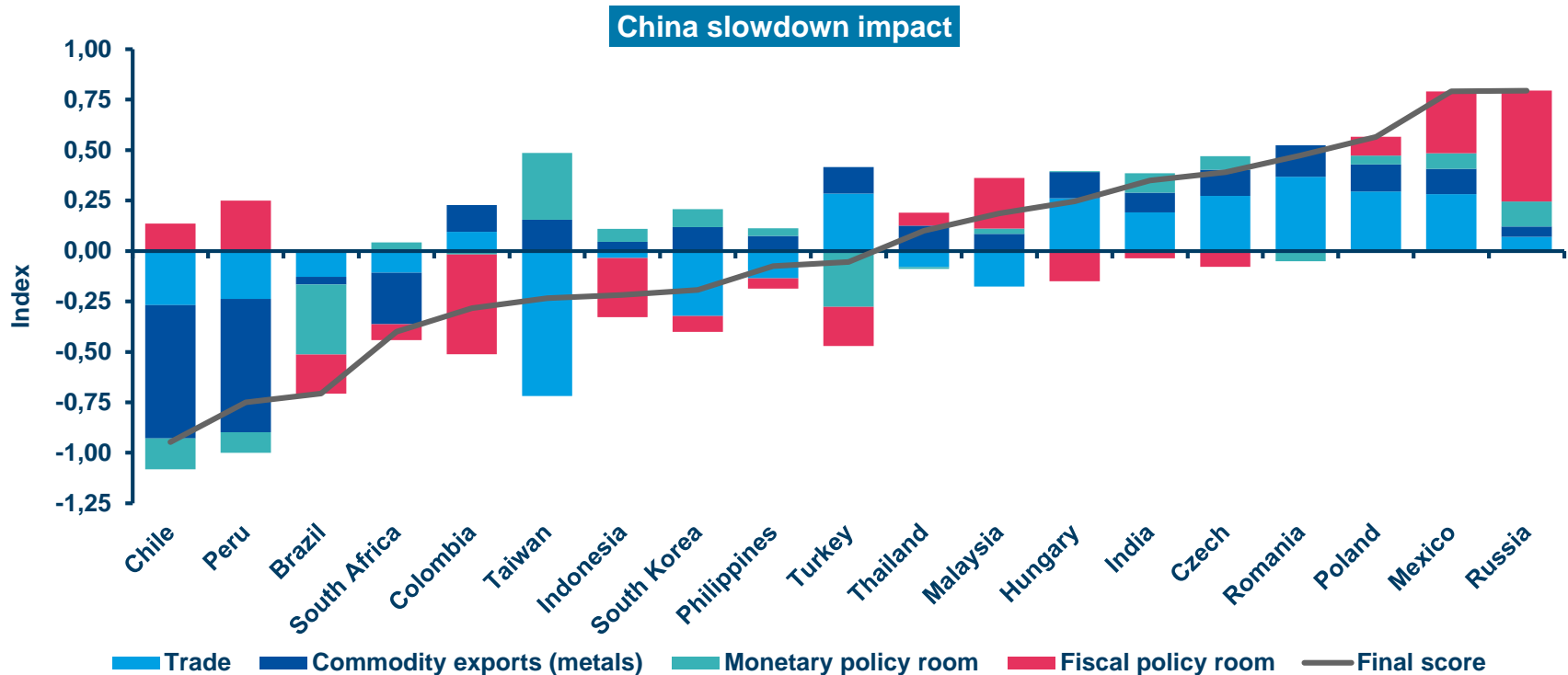


After a strong recovery in H2 2020 and in H1 2021, Chinese data has generally been disappointing in Q3, with exports being the only exception. We have downgraded China 2021 growth expectations to 8.3% down from 8.7% previously, and 2022 growth at 4.9% against 5.4% previously. We expect a slight growth rebound Q1 2022, as global supply constraints ease and energy use quotas renew.

Source: Amundi Research. Data is as of 22 September 2021.

Source: Amundi Research, Datastream, CEIC. Data is as of September 2021.

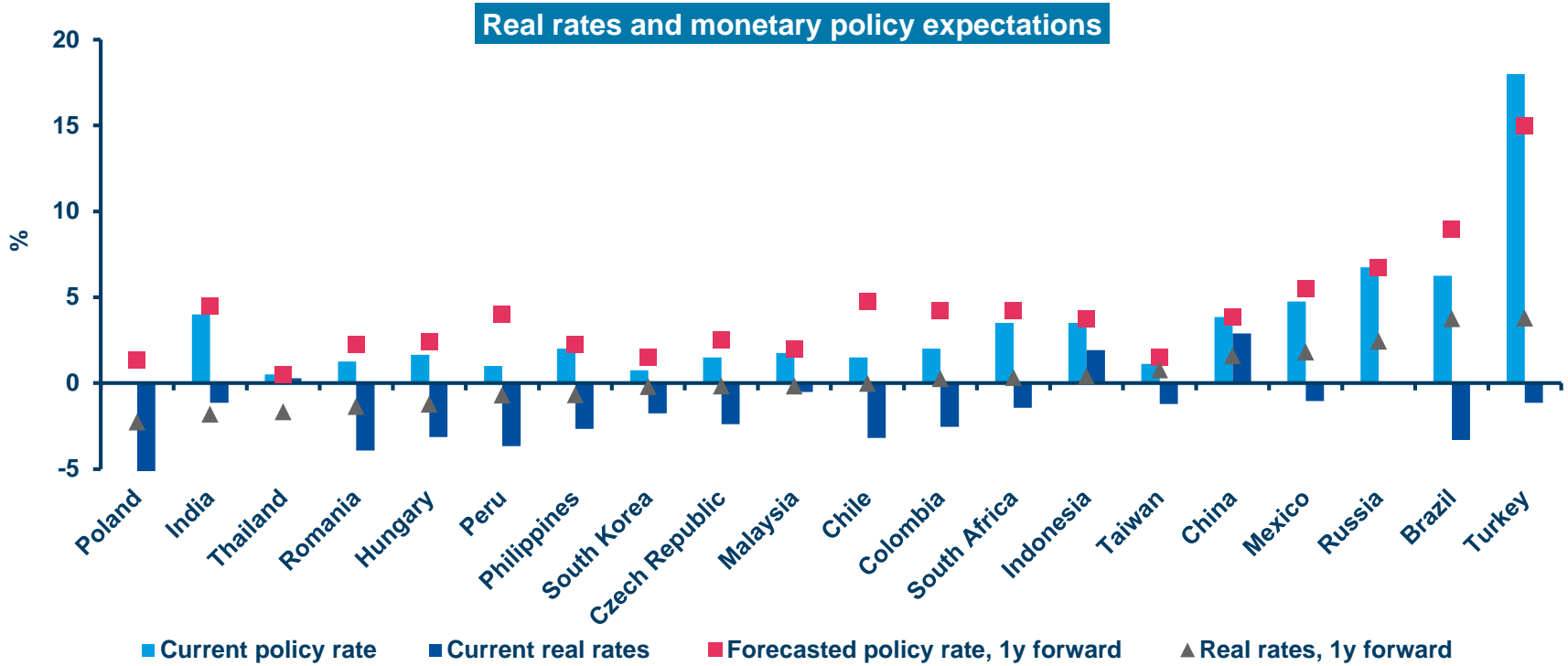
China's slowdown may hit commodity-exporter countries



» China's growth deterioration may spillover to those EM with strong trade linkages and commodity exposure to China, as long as the available policy room to counteract such a slowdown is limited. Latin American countries could be the most affected, while Russia and Mexico may be able to offset the negative impact thanks to the large fiscal room available.

Source: Amundi Research, OECD, WTO, CEIC, Bloomberg, IMF. Data is as of September 2021. Four parameters are taken into account to assess the impact of China slowdown on other EM: trade exposure to China, commodity exports (metals specifically), and two parameters to measure the available policy room to offset the external shock. These two indicators refer to the monetary policy room (domestic and external conditions, with a focus on inflation) and to the fiscal policy room.

Peak monetary tightening should be close



» The overall EM monetary policy stance has tightened. Monetary policy is normalising faster than anticipated on strong inflation trends, even though real rates remain negative in a few countries and are moving slowly towards more neutral levels.

Source: Amundi Research, Bloomberg. Data is as of 30 September 2021.

Main risks to monitor in the EM space

Tapering



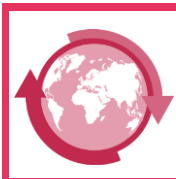
A slow Fed tapering should not derail the outlook for EM assets, but a possible tightening of financial conditions remains an area for attention

Inflation



Inflation remains high in some countries and some CBs have already raised rates. We could see some rate stabilisation, but inflation is a key global risk

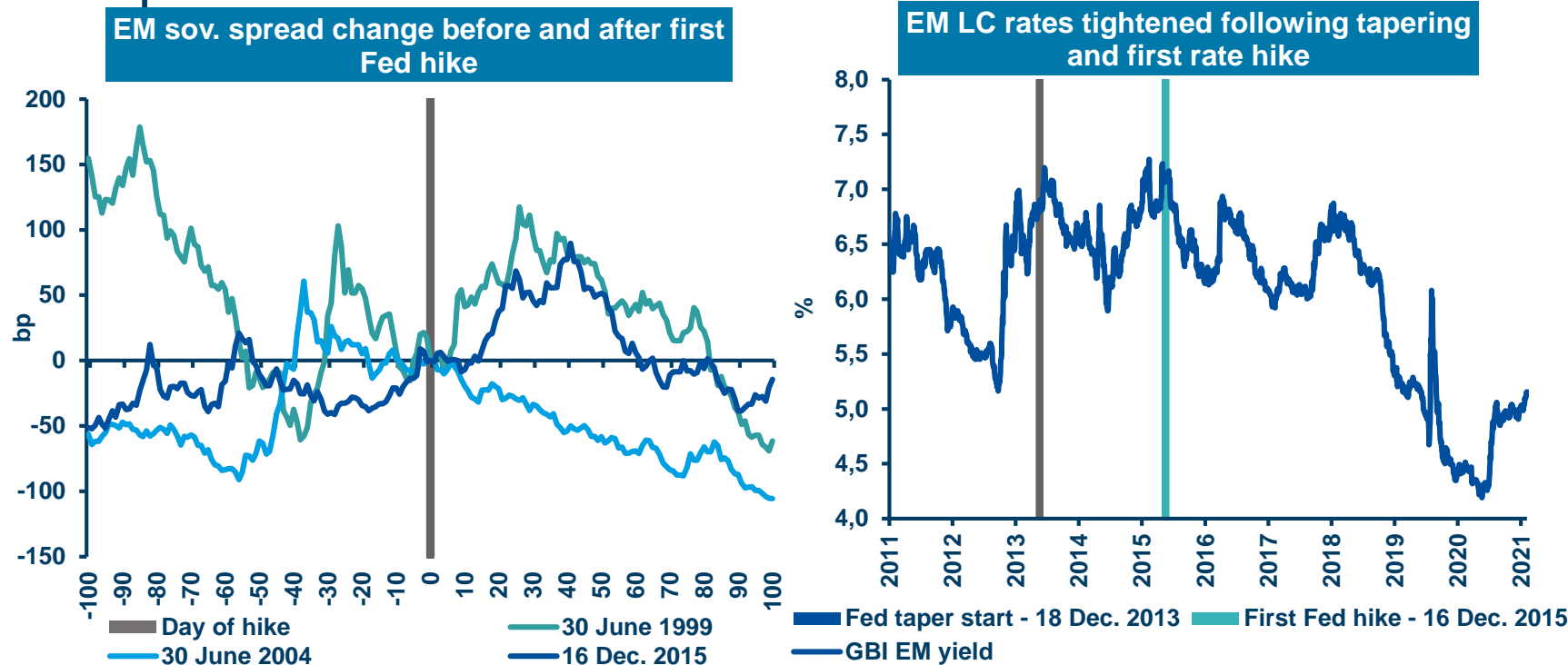
Idiosyncratic and geopolitics



Vulnerabilities such as idiosyncratic stories, geopolitical tension, or darkening political landscapes are moving under the spotlight

Source: Amundi as of 30 September 2021. CB: central banks.

Fed policy normalisation: slow and prudent, with no major disruption on EM bonds

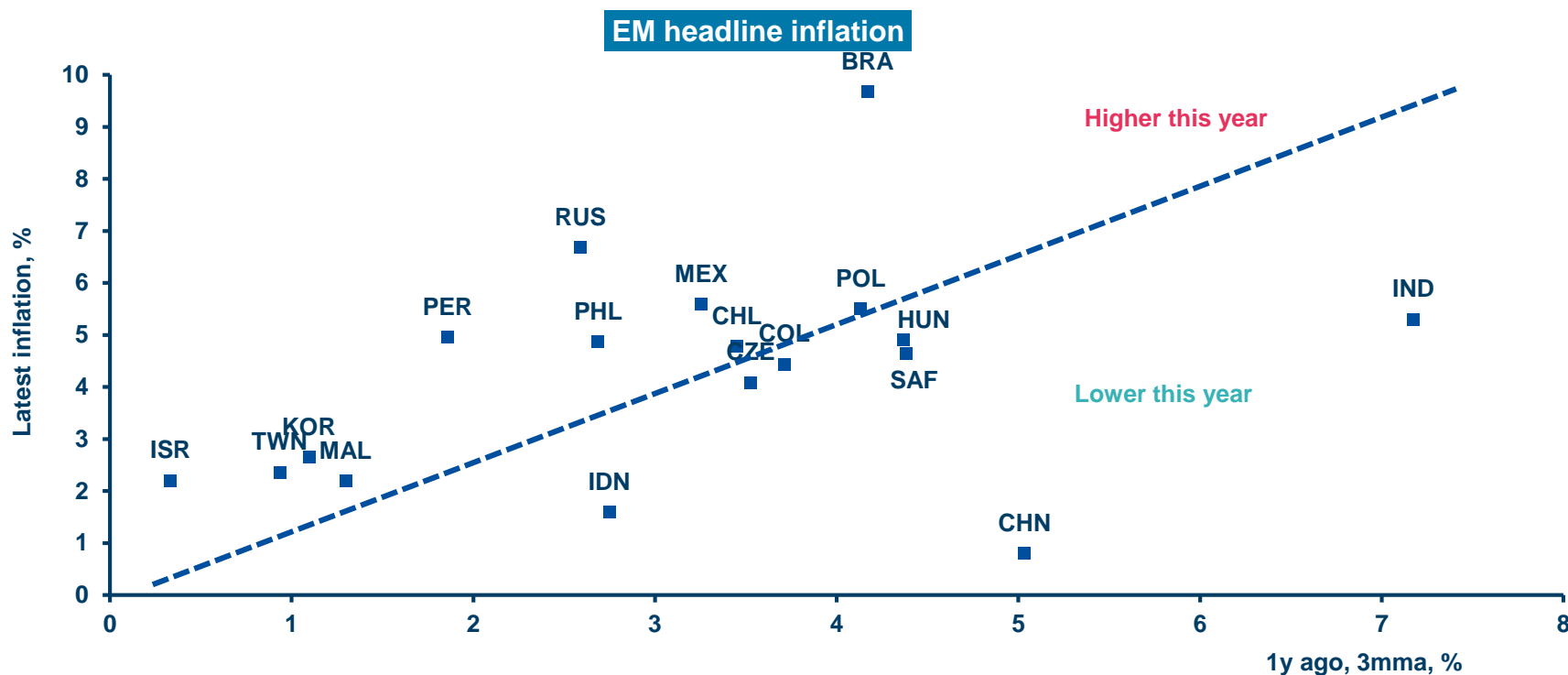


» We could expect some volatility in EM debt amid Fed policy normalisation, but the process should be very slow and the impact limited. Firstly, prospect of any rate hike remains at least a year away. Secondly, looking at the first hike of the most recent Fed tightening cycles, EM sovereign spreads actually tightened three months after the first hike. Finally, the most recent tightening cycle showed declining yields after the rate hikes.

Source: Amundi, Bloomberg. Data is as of 21 September 2021.

Source: Amundi, Bloomberg. Data is as of 21 September 2021. GBI EM: Government Bond Index Emerging Markets.

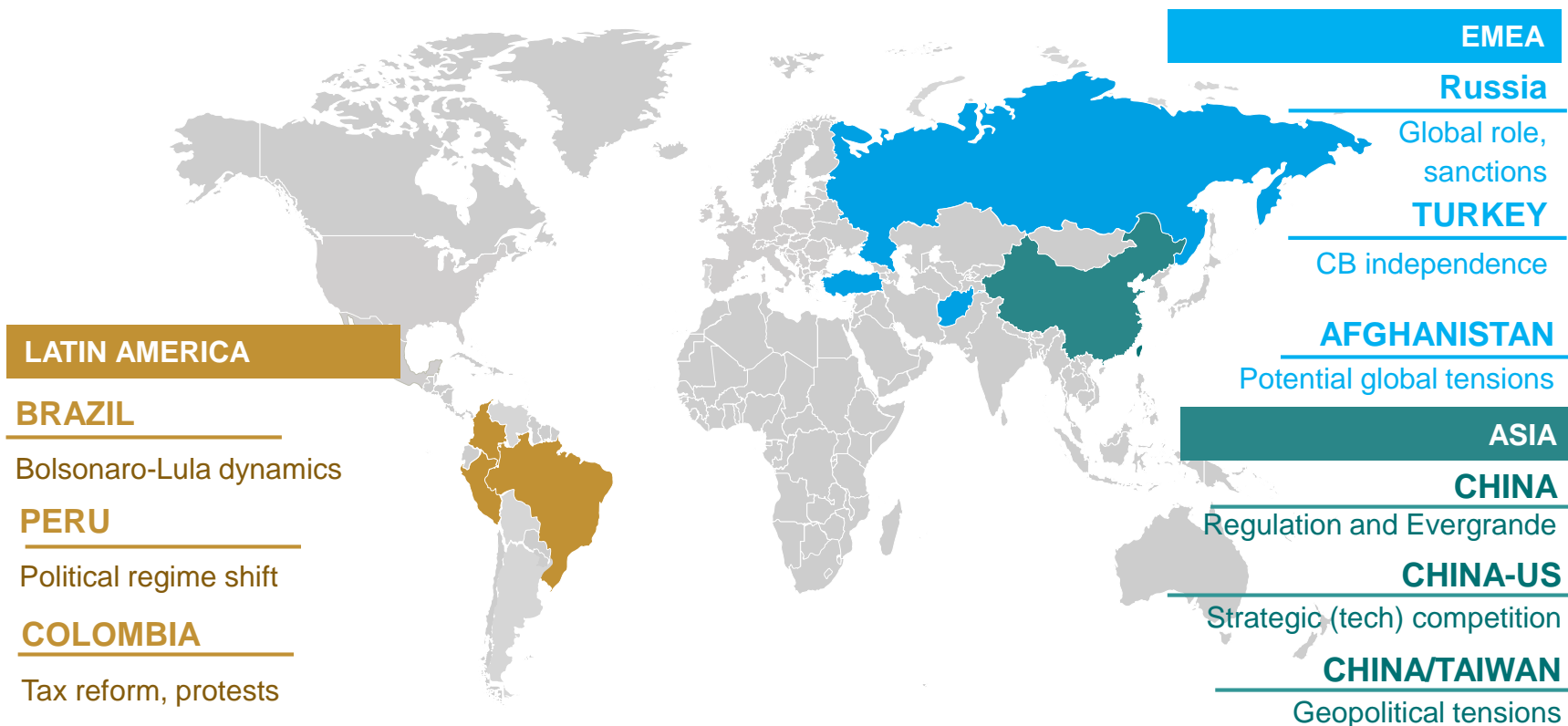
EM inflation pressure is strong, especially in Latam and CEEMEA



» Many EM are facing high inflation pressure from input costs (e.g., food, commodities). From a regional standpoint, a robust economic rebound is pushing inflation up most in Latin America and CEEMEA, while Asia is enjoying a more benign picture due to more sluggish growth dynamics. In China inflation is contained, but PPI is on the rise.

Source: Amundi Research. Data is as of 21 September 2021. CB: central banks. Current data refers to CPI headline inflation as of August 2021, except for South Africa and Malaysia data refers to CPI headline inflation as of July 2021. CPI pre-pandemic level refers to the median of December 2019, January 2020 and February 2020. Note: Turkey data is not included (inflation picked up from 11.8% to 19.3% YoY). CEEMEA: Central & Eastern Europe, Middle East and Africa.

Main geopolitical hot spots and a busy election year



Source: Amundi as of 21 September 2021.

EM high-conviction ideas



EM equity to play EM-DM growth differential

Vaccination progress, EM-DM growth premium, economic rebound, and **earnings recovery** are the main drivers of EM equities. Valuations favour EM stocks in the current global context. Investors' positioning is light. Overall we maintain a positive view on the asset class, with a focus on domestic demand driven sectors.



Asia and China at the core

China's assets have suffered during the recent turmoil on regulation and the cooling of the housing sector. The medium/long-term outlook remains constructive. **China may become a core component** of global portfolios and Chinese debt offers a source of yield and diversification.



EM bonds as income source and FX opportunities

In a persistently low-rate environment, **EM bonds offer a source of income** across both local and hard currency debt. Inflation should be less of a concern for the latter. We maintain a **cautious view on duration** and selectivity remains crucial. Selected currencies could benefit from attractive valuations, although the outlook is still cautious.

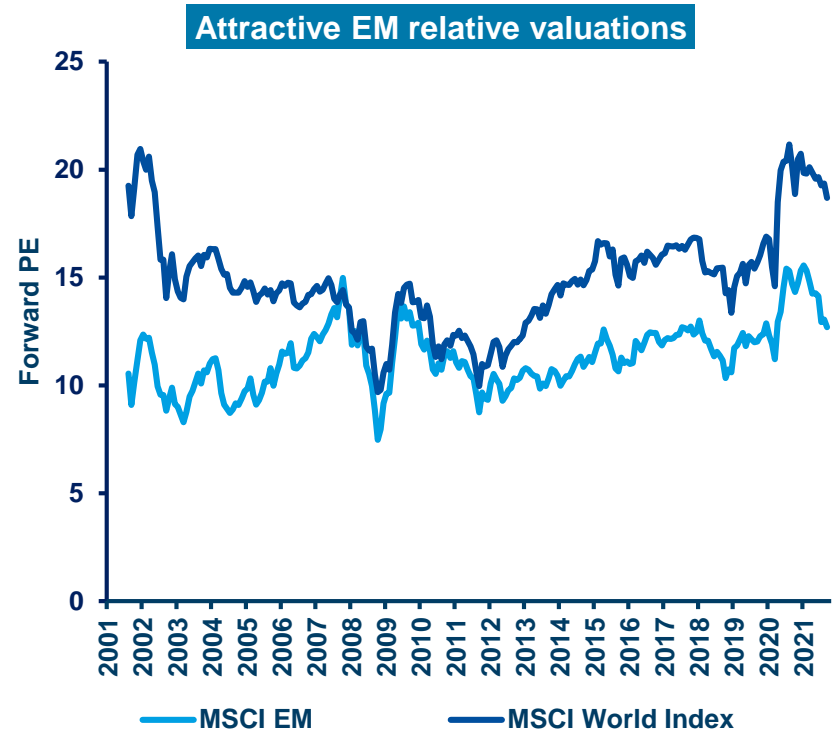
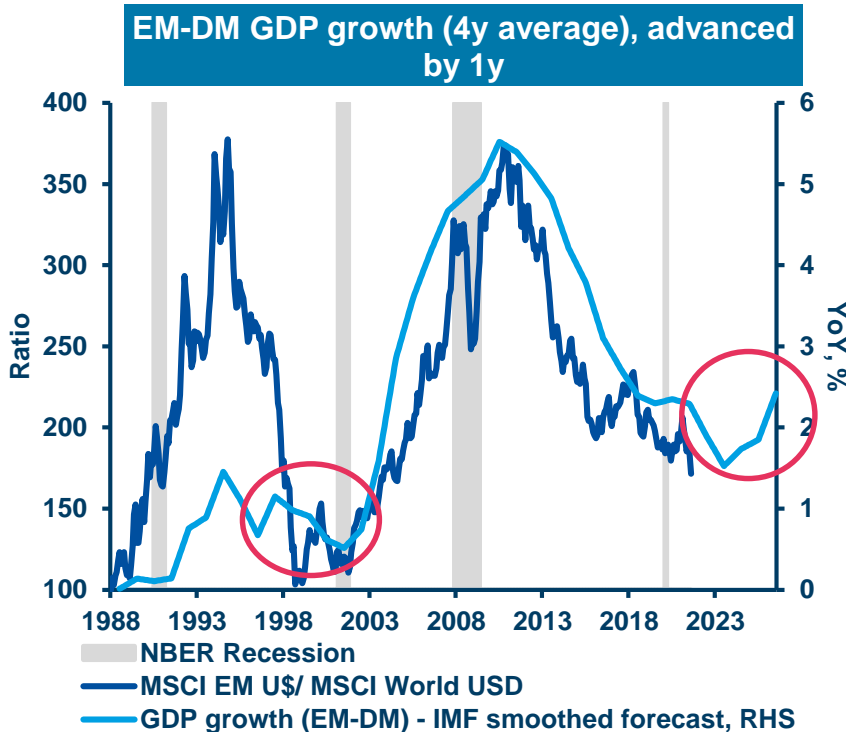


The rise of ESG in emerging markets

Growing investor demand for green bonds could strengthen the potential for **EM green bond** markets, offering an opportunity for developing countries and global investors to **play the green transition**. Projected 2021-23 EM green bond issuance is larger than the EM green bond stock up to 2020.

Source: Amundi as of 4 October 2021.

EM equity: attractive valuations in a global context







» A few catalysts support a constructive view on EM equity, especially for long-term investors. Among them, the rebound in global trade, the widening EM-DM growth gap (expected to be back in favour of EM in 2022), the acceleration of vaccine programmes across EM, and the normalisation of earnings and profitability. Valuations are not expensive, in relative terms, and investors' positioning is light.

Source: Amundi Research, Datastream and IMF annual data. Data is as of September 2021.

Source: Amundi Research, Datastream. Data is as of 27 September 2021.

Major investment convictions in EM equities

	<p>Constructive on countries able to benefit from the commodity cycle and exports</p>	<p>Russia, Indonesia</p>
	<p>Positive on some Asian countries, the engine of EM growth</p>	<p>India, Korea, Hong Kong, Vietnam, New Silk Road</p>
	<p>Cautious stance amid regulatory action; long-term growth story remains intact</p>	<p>China</p>
	<p>Defensive on countries with deteriorating fundamentals or possible idiosyncratic stories</p>	<p>Mexico, Saudi Arabia, Turkey, Malaysia, South Africa</p>

Source: Amundi as of 6 October 2021.



Equity opportunities in EM Asia, with re-opening stories

1 China – *cautious*
Earnings momentum to further deteriorate amid regulatory crackdown, rising inflation impacting purchasing power and margins, and property tightening. Retain a preference for domestic market vs offshore market despite valuation differential, for Industrials and energy over Financials, and for sportswear and eCom over food delivery within consumer.

2 India – *positive*
Digital transformation, Made in India, financialisation of savings and increasing weight in indices with more IPOs to come in new economy sectors; although short-term, this is offset by high valuations in cyclical and new economy sectors.

3 Taiwan – *cautious*
Turning cautious on semiconductors due to valuations, with most of the positive news on pricing and volume already priced-in; still constructive on consumer sectors with good yield support.

4 South Korea – *positive*
Healthy exports, attractive valuations, mostly in the still-dominant technology and auto sectors.

5 Thailand – *neutral*
Turning incrementally more positive on faster vaccinations than expected and more attractive valuations. Favour reopening plays in staples while remaining cautious on banks.

6 Malaysia – *cautious*
Cautious on sectors exposed to domestic consumption and investment (banks, construction, telecoms); more constructive on exporters (e.g. commodities)

7 The Philippines – *neutral*
Turning incrementally more positive on faster vaccination than expected and attractive valuation. Favour reopening plays in real estate and conglomerates.

8 Hong Kong – *positive*
Focusing on reopening plays excluding real estate. Still favour insurance and travel-related consumer names.

9 Vietnam – *positive*
Now the largest in MSCI Frontier and could benefit from an upgrade to EM status in MSCI indices. Favour banks and real estate.

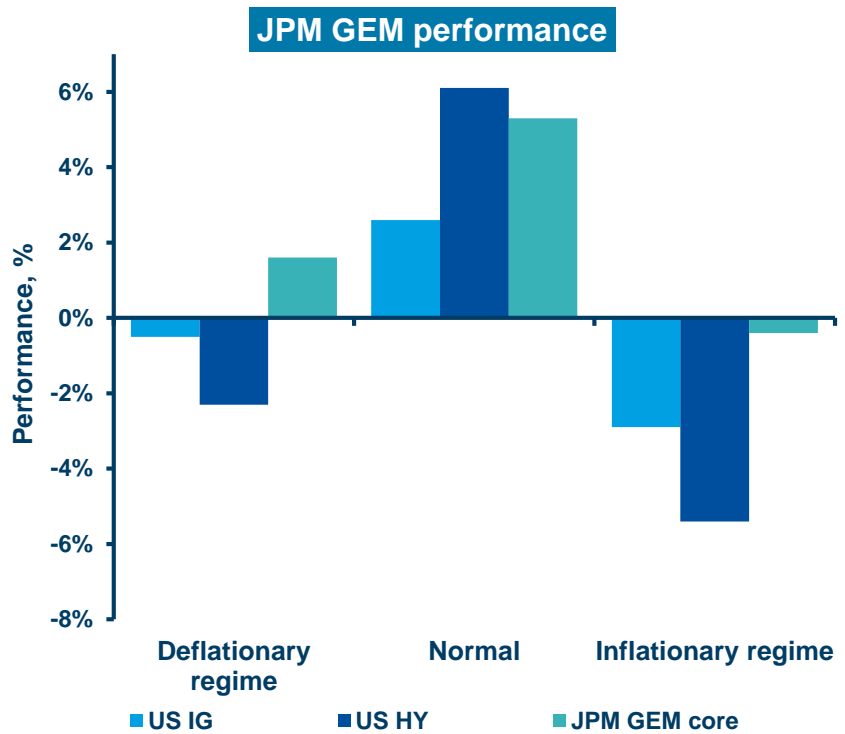
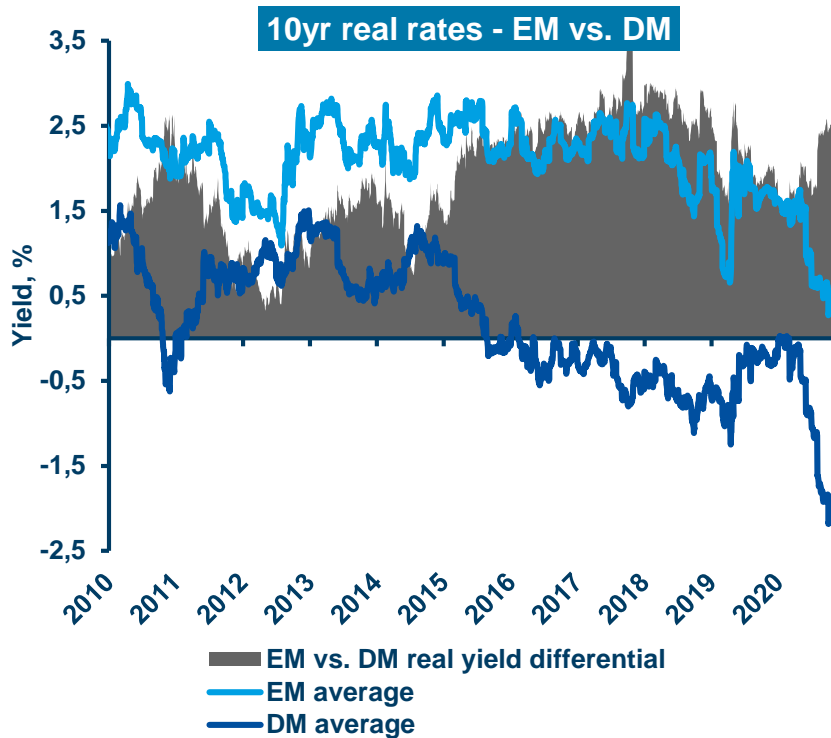
10 Indonesia – *positive*
Strong cyclical rebound with reopening and rising commodity prices, favoring the banks and commodity-related names

Colours indicate Amundi equity view on the country for Q4



Source: Amundi. Data is as of 21 September 2021.

EM real yields offer some compelling pick-up over DM



» EM countries present a wide range of inflation trends, but some of them have been already passed the peak, while in DM inflation is rising quickly, putting pressure on real yields. Historically, EM bonds have outperformed during inflationary periods. The EM-DM real yield differential suggests value in the EM debt space.

Source: Amundi analysis on Bloomberg data as of 24 September 2021.

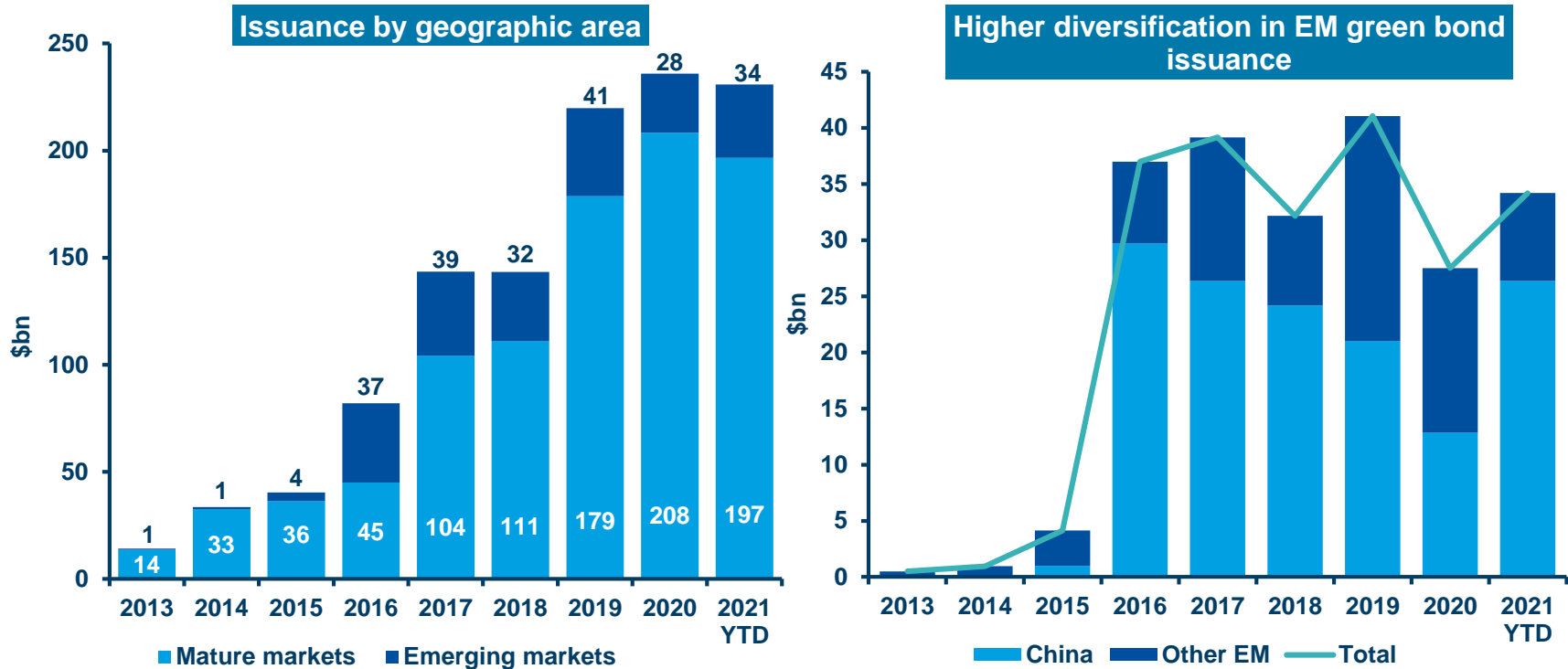
Source: Amundi Research. Data is as of 29 June 2021. Credit performance is measured as risk premium against US and EU govies and local-currency terms. Inflation data is from 31 January 1959 to 31 May 2021, market data is from 31 January 1999 to 31 May 2021.

Major investment convictions in EM bonds and FX

SOV	Constructive outlook on HC space with a preference for HY over IG	Russia, Brazil, South Africa, Argentina
LOC	More discerning view, focus on countries and currencies where the tightening cycle is almost over	Russia, South Africa, China, Brazil (inflation-linked bonds), Serbia
CORP	Supported by improving earnings, attractive spreads vs. DM credit	Mexico energy, Ukraine utilities, Quasi-sovereign
FX	Commodity momentum plays in favour, valuations are supportive	RUB, COP, PLN, IDR

Source: Amundi as of 30 September 2021. HC: hard currency. IG: investment grade. HY: high yield. RUB: Russian Ruble. COP: Colombian Peso. PLN: Polish Zloty. IDR: Indonesian Rupiah.

Rising relevance of sustainable investing in EM



» While EM ESG issuance is much smaller than that of DM, the former is crucial for advancing the ESG agenda globally, giving a significant role to EM issuers in coming years. In this respect, the upcoming COP26 in Glasgow will measure the potential for EM green bonds to develop into a credible asset class to manage the green transition in the near future.

Source: Amundi, IIF. Data is as of 17 August 2021. 2021 YTD data is up to June 2021.

Source: Amundi, IIF. Data is as of 17 August 2021. 2021 YTD data is up to June 2021.

Key takeaways

EMERGING MARKETS

EM EQUITIES

EM BONDS

KEY THEMES

- Play the widening EM-DM growth premium, attractive valuations compared to DM, earnings re-acceleration, long-term focus on domestic consumption and on Asia.

- Source of yield in a world of historically low rates.
- Short-duration bias, flexible and active approach with an eye on monetary policy cycle.

HOW TO PLAY?

- **Global:** diversify and increase value/cyclicals over growth, focus on domestic growth and appealing valuations.
- **Asia:** long-term call for the region remains intact as an area to be invested in thanks to its global traction and rising domestic demand. China and India are also a source of diversification in global portfolios.
- **Frontier markets opportunities:** invest in long-term growth story, such as India.
- **New Silk Road:** play the rising role of China in the geopolitical landscape.

- **EM short-term bonds** are an attractive and defensive opportunity.
- **Aggregate:** opportunity to address market volatility with flexible solutions, unconstrained by traditional benchmarks.
- **Corporates:** attractive carry compared to alternative options, supported by earnings growth.
- **Green bonds:** strong growth market, diversifying rapidly across sectors and countries.

Explore cross-asset opportunities in EM

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Indices reference and definitions

Bond Indices (JPMorgan)

Sov. HC HY = JPM EMBI Global Diversified High Yield; Sov. HC = JPM EMBI Global Diversified Composite; Sov. HC IG = JPM EMBI Global Diversified Inv. Grade; Local FX = JPM GBI-EM Global Diversified FX Return; Local HC = JPM GBI-EM Global Diversified Composite Unhedged USD; Local Euro = JPM GBI-EM Global Diversified FX Return in EUR; Local Rates = JPM GBI-EM Global Diversified Composite LOC; Corp. HC HY = JPM Corporate Broad EMBI Diversified High Yield; Corp. HC = JPM Corporate EMBI Broad Diversified Composite; Corp. HC IG = JPM Corporate Broad EMBI Diversified High Grade.

Equity Indices (MSCI)

Argentina = MSCI Argentina Net Total Return; Brazil = MSCI Brazil Net Total Return; China = MSCI China Net Total Return; Czech Republic = MSCI Czech Republic Net Total Return; Colombia = MSCI Colombia Net Total Return; Egypt = MSCI Egypt Net Total Return; India = MSCI India Net Total Return; Indonesia = MSCI Indonesia Net Total Return; Mexico = MSCI Mexico Net Total Return; Peru = MSCI Peru Net Total Return; Philippines = MSCI Philippines Net Total Return; Poland = MSCI Poland Net Total Return; Russia = MSCI Russia Net Total Return; South Africa = MSCI South Africa Net Total Return; South Korea = MSCI Korea Net Total Return; Taiwan = MSCI Taiwan Net Total Return; Thailand = MSCI Thailand Net Total Return; Turkey = MSCI Turkey Net Total Return; Emerging Markets = MSCI Emerging Net Total Return.

Yield & Duration Indices

German Govt Bonds = JP Morgan GBI Germany Index; US Govt Bonds = JPMorgan GBI US Index; Euro IG Bonds = Bloomberg Barclays Pan European Aggregate Corporate; US IG Bonds = Bloomberg Barclays US Aggregate Credit; Euro HY bonds = Bloomberg Barclays Pan-European High Yield ISMA; US HY Bonds = Bloomberg Barclays US Corporate High Yield; EMBI Div = JPMorgan EMBI Global Diversified Blended; CEMBI BD = JPMorgan CEMBI Div Broad Composite Blended; CEMBI BD HY = JPMorgan CEMBI Broad Div High Yield; Euro Corp Short Term = Bloomberg Barclays Euro Corporate 1-3Yr; US Corp Short Term = Bloomberg Barclays US Corporate 1-3Yr; EMBI Short Term = JPMorgan EMBIG Diversified 1-3Yr.

Indices reference and definitions

Definitions

- **Basis points:** one basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Carry:** the carry of an asset is the return obtained from holding it.
- **CEEMEA:** Central and Eastern Europe, Middle East and Africa.
- **Correlation:** the degree of association between two variables; in finance, it is the degree to which assets or asset class prices have moved in relation to each other. Correlation is expressed by a correlation coefficient that ranges from -1 (perfectly negative correlated) through 0 (absolutely independent) to 1 (perfectly positive correlated).
- **Credit spread:** differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration possible embedded options.
- **Diversification:** Diversification is a strategy that mixes a variety of investments within a portfolio, in an attempt at limiting exposure to any single asset or risk.
- **Duration:** a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates, expressed as a number of years.
- **External vulnerability index:** this index is built by aggregating five different indicators that can monitor a country's dependence on overseas economies and capital flows.
- **FX:** FX markets refer to the foreign exchange markets where participants are able to buy and sell currencies.
- **Investment grade:** Refers to securities issued by an issuer of negotiable debt securities (Treasury bonds...) or bonds for which the Standard & Poor's rating is greater than or equal to BBB-. 'Investment grade' bonds are considered by the various rating agencies as having a low risk of non-repayment.
- **High yield:** High yield paying bond with a low credit rating due to the high risk of default of the issuer.
- **P/E ratio:** The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS).
- **Quasi sovereign:** companies wholly or partially owned by the government.
- **Spread:** the difference between two prices or interest rates.
- **VIX:** the CBOE volatility index. The VIX index is a measure of market expectations of near-term volatility on the S&P 500 (US equity).
- **Volatility** is a statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

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