Confidence must be earned

Amundi
ASSET MANAGEMENT

Q4 2019

Emerging Markets Charts & Views

A tug of war between weaker growth and looser policies

Investment Insights | Market Stories

Emerging markets: a tug of war between weaker growth and looser monetary policy

Yerlan Syzdykov

Global Head of Emerging Markets

Dear client,

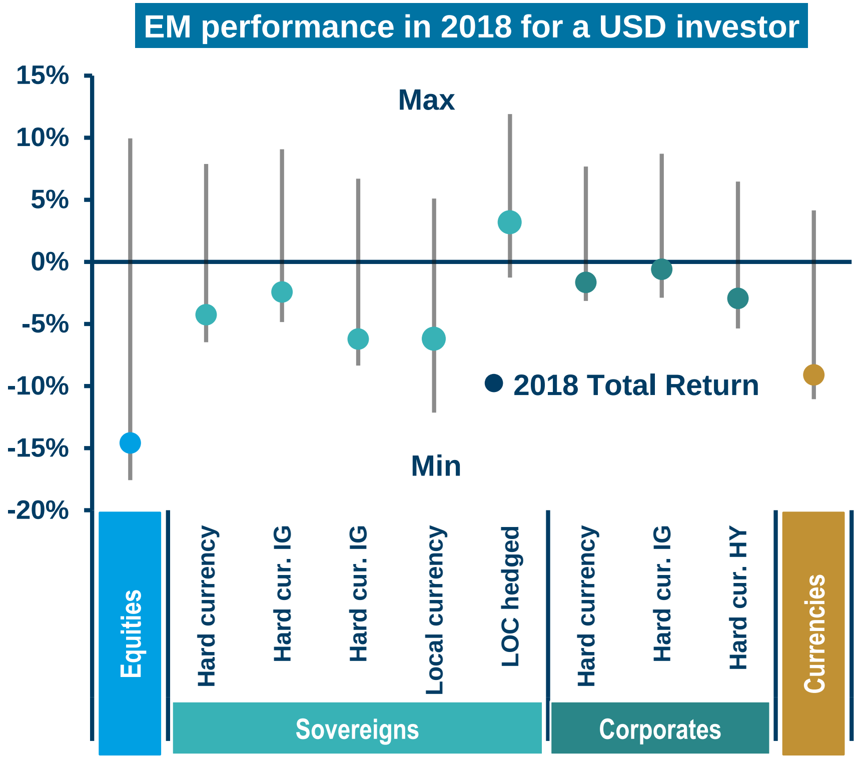
Emerging economies have faced a backlash in the last few months as a consequence of the global economic weakness and the uncertainty related to global trade. This weighed on the performance of EM equities in the third quarter, although they recovered somewhat in September. EM debt proved more resilient, supported by investors' appetite for yield. Idiosyncratic events (Argentina, Saudi Arabia and Turkey, to name a few) also impacted the overall more fragile environment for EM. As a consequence, we have revised down our EM GDP growth forecast to 4.2% in 2019 and 4.4% in 2020, from 4.3% and 4.5%, respectively, with significant country divergences.

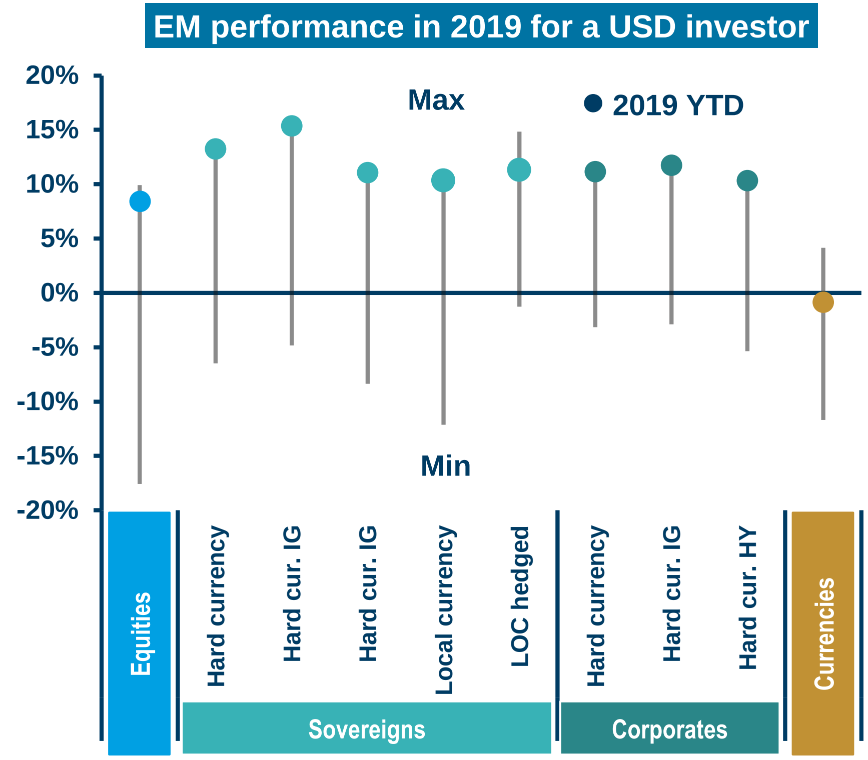
While global economic growth will remain lacklustre for some time yet, we see several factors supporting risk sentiment for EM assets. Global synchronised easing by central banks could continue to support EM economies and highlight the relative attractiveness of EM assets. In addition, the prospect of a weaker dollar as the Fed expands its balance sheet again could be supportive for EMs. While weighing on growth and confidence, trade wars may open up some selective opportunities at the country/sector level and may produce some winners among EM economies from a relocation of the global supply chain.

In conclusion, although we prefer to maintain an overall cautious stance for the time being, our outlook is still constructive for EM assets in the medium term – as long as a global recession is avoided. EM bonds in hard currencies could continue to be seen as a source of income in a world of scarce yield, and local currencies could come back in focus with a weaker dollar in sight. In EM equities, opportunities at country, regional and sector level will be favoured in a world of increasing fragmentation and a reshaping geopolitical equilibria. Nonetheless, investors will continue to face headwinds going forward as global uncertainties are set to remain and they will have to deal with scarce market liquidity conditions. In such an environment, skilful selection and a careful top down assessment of global and country dynamics will be essential to limit risks and deliver sustainable returns.

Yerlan Syzdykov

Strong YTD performance for EM, with recovery from 2018

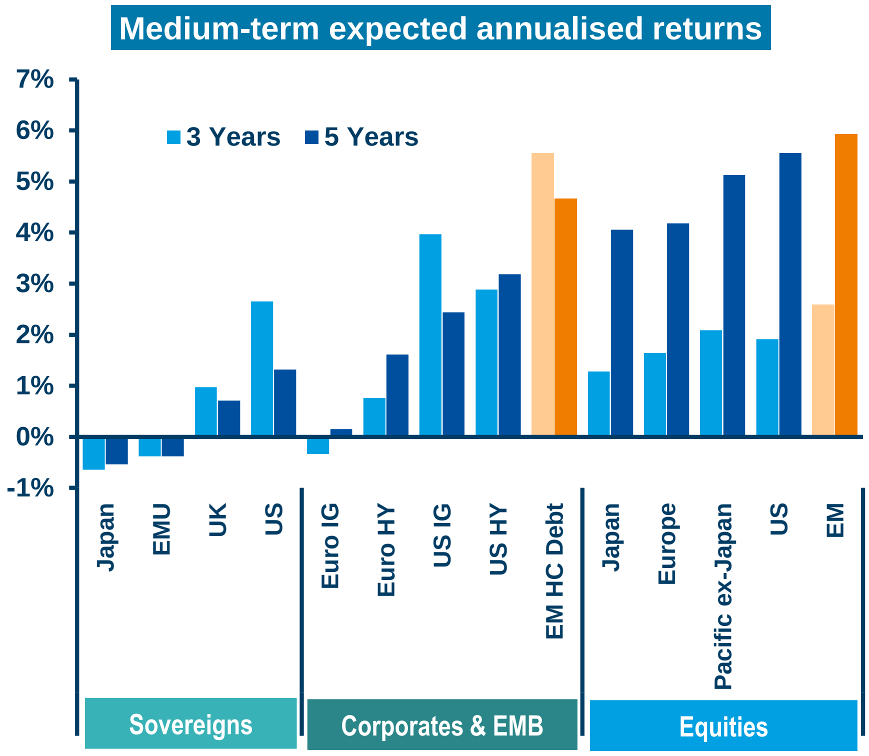


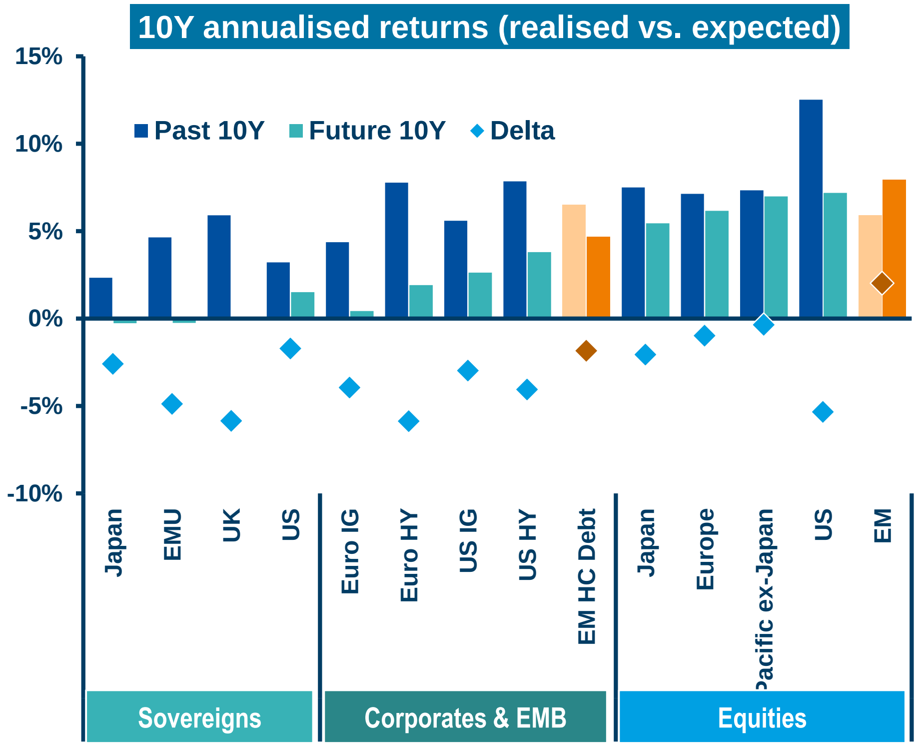


» EM assets have delivered a positive performance year to date across asset classes, with the exception of EM currencies. Last year financial and macroeconomic headwinds weighed on investor sentiment and dragged down EM returns.

Source: Amundi elaborations on Bloomberg data. As of 21 October 2019. **Past performance is no guarantee of future results.**

Emerging markets: source of return for the mid to long term





From a medium- to long-term perspective, emerging markets represent a key source of return potential in a world where expected returns are lower compared with the last 10 years.

Source: Analysis by Amundi Research on Bloomberg data. As of 23 October 2019. Macro figures as of last release. Forecasts for annualised returns are based upon estimates and reflect subjective judgements and assumptions. These results were achieved by means of a mathematical formula and do not reflect the effect of unforeseen economic and market factors on decision-making.

EM diversification benefits: lower return correlations

	EM Local bond	EM HC sov	EM equities	S&P500	US Treasury	US HY	Euro Stoxx	Commodity Index	DXY Index
EM local bond	1.00								
EM HC sov	0.57	1.00							
EM equities	0.61	0.47	1.00						
S&P500	0.27	0.40	0.64	1.00					
US Treasury	-0.03	0.26	-0.23	-0.33	1.00				
US HY	0.26	0.49	0.55	0.74	-0.26	1.00			
Euro Stoxx	0.27	0.40	0.65	0.76	-0.35	0.64	1.00		
Commodity Index	0.22	0.04	0.31	0.15	-0.11	0.14	0.21	1.00	
DXY Index	-0.66	-0.33	-0.40	-0.12	0.02	-0.17	0.01	-0.12	1.00

» In an environment where the market is increasingly worried about late-cycle dynamics, it is worth considering the long-term cross-asset correlations. EM hard currency debt has had a sub 50% correlation with global equities over the past 16 years. Its correlation with the commodity index has been close to zero, reflecting the diversification of the asset class, which incorporates commodity importers and exporters.

Note: Correlation of weekly returns, January 2003 – September 2019. Source: Amundi elaborations on Bloomberg data. As of 11 October 2019.

Emerging markets high conviction ideas – Q4 2019

Macro Themes
Equities
Fixed Income
Currencies

Macro themes

There are five main themes to watch closely in the EM space: (1) the trade story and how it unfolds, as this could negatively affect global growth and financial markets, but also benefit some EM economies due to the reshuffle in global supply chains; (2) the global growth outlook and the expected widening in the growth differential between EM and DM; (3) central bank measures, with the most important being the Fed; (4) China's slowdown and how the government acts to avoiding hard landing scenarios; and (5) the risks related to the geopolitical landscape and idiosyncratic country stories.

Equities

In the EM space valuations are supportive and the market could benefit in the case of a mini-deal on the trade front. We remain broadly positive on domestic consumption countries for the next few months (such as Brazil, Indonesia, Russia and India) and have turned moderately constructive on China even though we expect some volatility in the near future. At a sector level, we favour information technology (especially in Korea and Taiwan) and the energy sector where valuations and free cash flow yield are very attractive.

Fixed Income

The asset class could be a net beneficiary of the tug of war between weaker growth and looser monetary policy. In addition, expectations for a widening of the emerging markets growth premium versus developed markets in 2020, along with the benign inflation environment, provide a supportive backdrop for investors in search of yield in EM debt. Nevertheless, we prefer to maintain an overall cautious stance for the time being. On a fundamental basis, Latin American countries are relatively more attractive at the moment, but we are carefully looking at the commodity outlook, which could weigh on this area.

Currencies

Despite most of the EM currencies being undervalued, we maintain our bearish view in the short term on EM currencies given the sluggish growth outlook. Risks to global growth remain to the downside, pressuring EM currencies. If political risks do not escalate and domestic reforms in EM continue, we could see a return of risk appetite for EM FX, which could benefit investments in local currencies.

Source: Amundi. Data as of 23 October 2019. EM = Emerging Markets, DM = Developed Markets.

Hot topics: tailwinds and headwinds blowing over EM

Trade: Global trade tensions (not only the US-China dispute) negatively affect global growth and financial markets. Some EM economies set to benefit from reshuffle in global supply chains.

Growth: Uncertainties surrounding the global growth outlook are still skewed to the downside. Growth differentials between EM and DM are likely to widen in favour of EM.

Central banks: Global synchronised easing from central banks (both DM and EM) could continue to support EM economies and highlight the relatively attractiveness of EM asset classes.

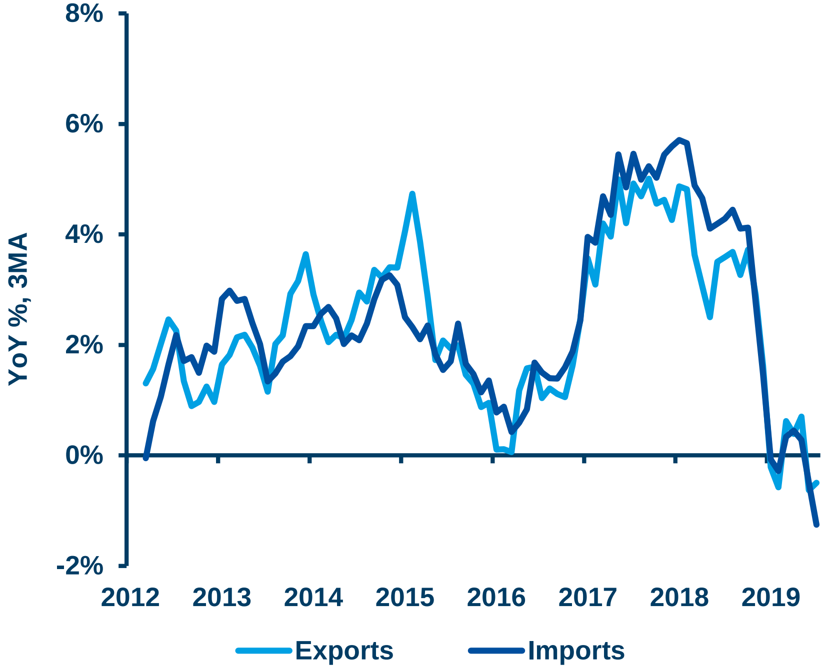
China slowdown: China's economy has been slowing and the Chinese government's stimulus will play a key role in managing the growth slowdown and avoiding hard landing scenarios.

Geopolitics: Vulnerabilities in emerging economies and idiosyncratic country stories remain persistent. Geopolitical events and the political agenda are constantly under the spotlight.

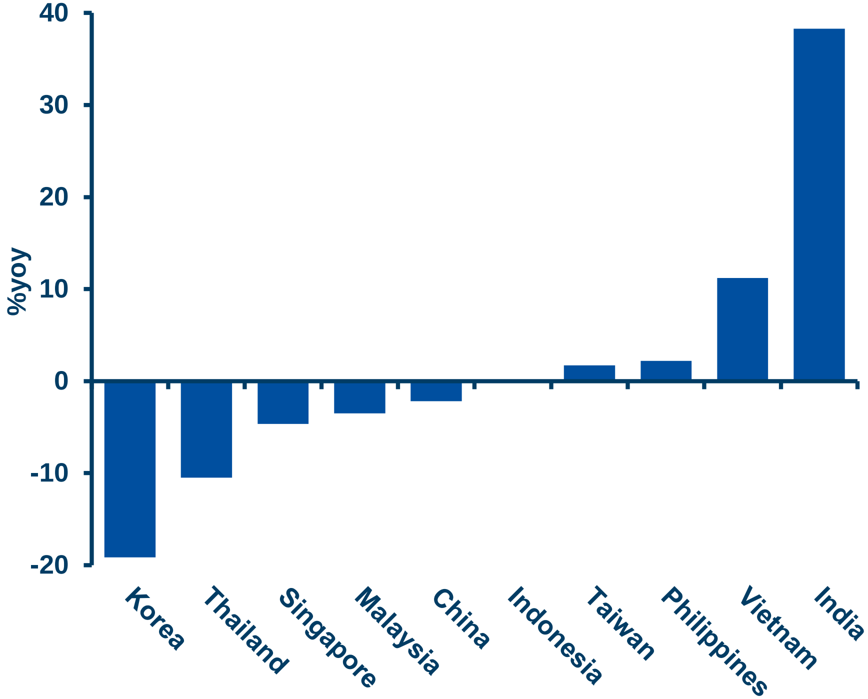
Source: Amundi. As of 25 October 2019.

Trade war weighs on growth, some economies may benefit

Global trade growth (volumes)



Changes in electronics exports in the first six months of 2019

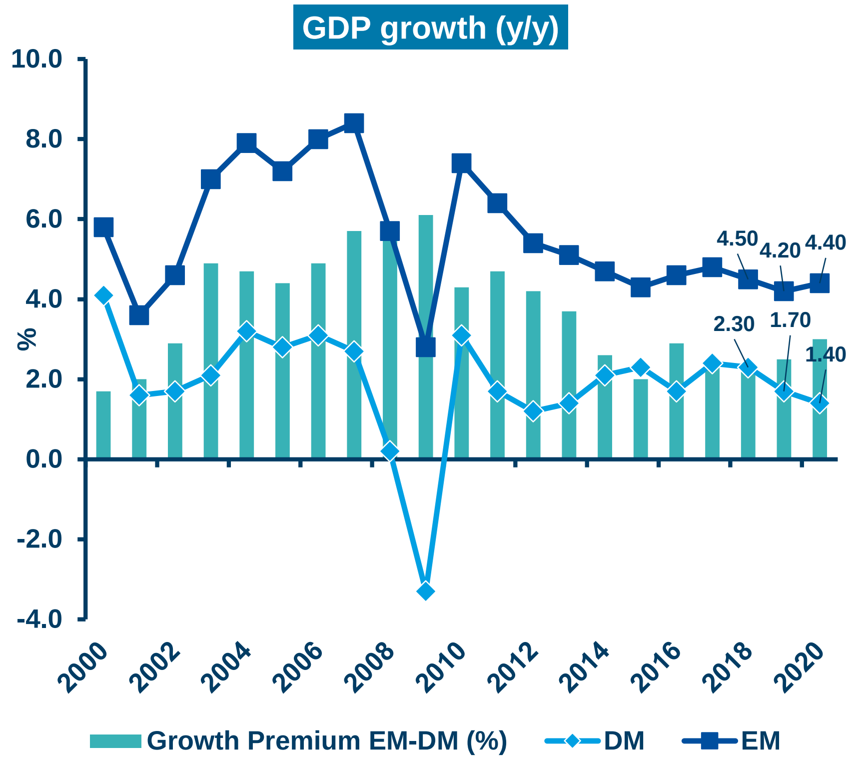


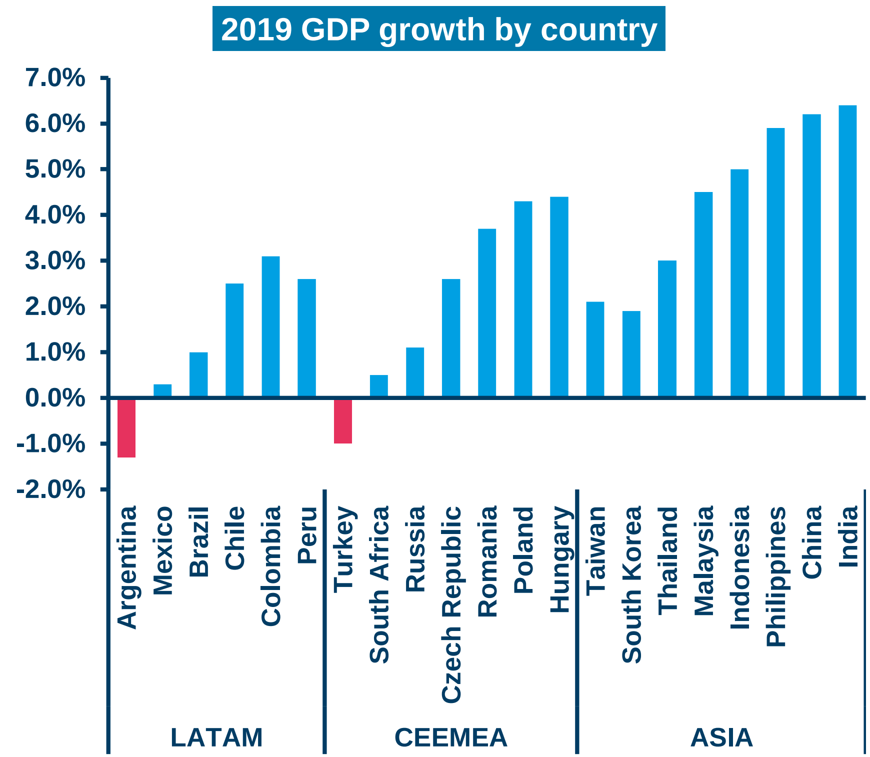
» Global trade volume growth has been falling significantly since the tariffs were implemented, with the WTO cutting its forecast for this year to the weakest level in a decade. Trade uncertainties are weighing on growth, while some economies, especially in Asia, are set to benefit from a relocation of the global supply chain away from China.

Source: Amundi elaboration on CPB World Trade Monitor data As of 10 October 2019.

Source: Gavekal data, Amundi. As of 16 October 2019.

Growth outlook still weak, some rebound in 2020 for EM





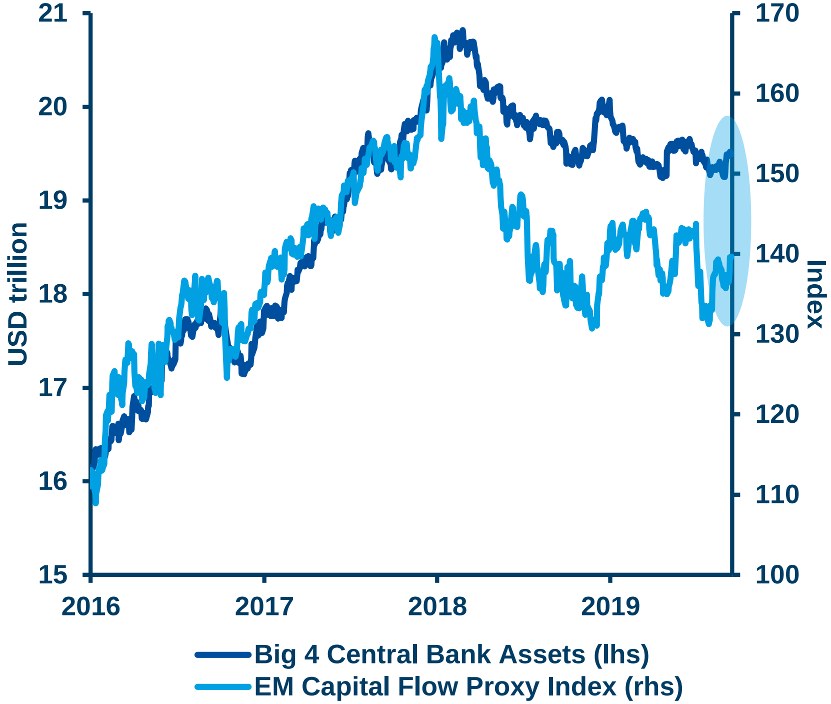
Global growth is weaker than expected and more vulnerable. As such, we have revised down our growth forecasts for most of the EM countries, with some rebound expected next year. As the EM universe is varied, it is important to focus on countries with lower external vulnerabilities and more room for maneuver on the fiscal/monetary front.

Source: IMF, Amundi Research estimates for 2019 and 2020. As of 15 October 2019.

Source: Amundi Research forecasts. As of 4 October 2019.

Global synchronised easing from central banks

CB balance sheets vs. EM capital flows



Monetary policy capacity \ Fiscal capacity	Low	Medium	High
Low	Colombia, South Africa	Turkey	Chile, Indonesia
Medium	Hungary, India, Poland	Philippines, S. Korea	Czech, Malaysia, Mexico, Russia
High	Brazil	China	Peru, Thailand

Fiscal capacity: relative assessment of fiscal fragility based on 14 variables related to fiscal accounts in the short- and long-term horizon.
MP capacity: relative assessment based on external vulnerability, inflation anchored.
These are not predictions on the next fiscal and monetary policies.

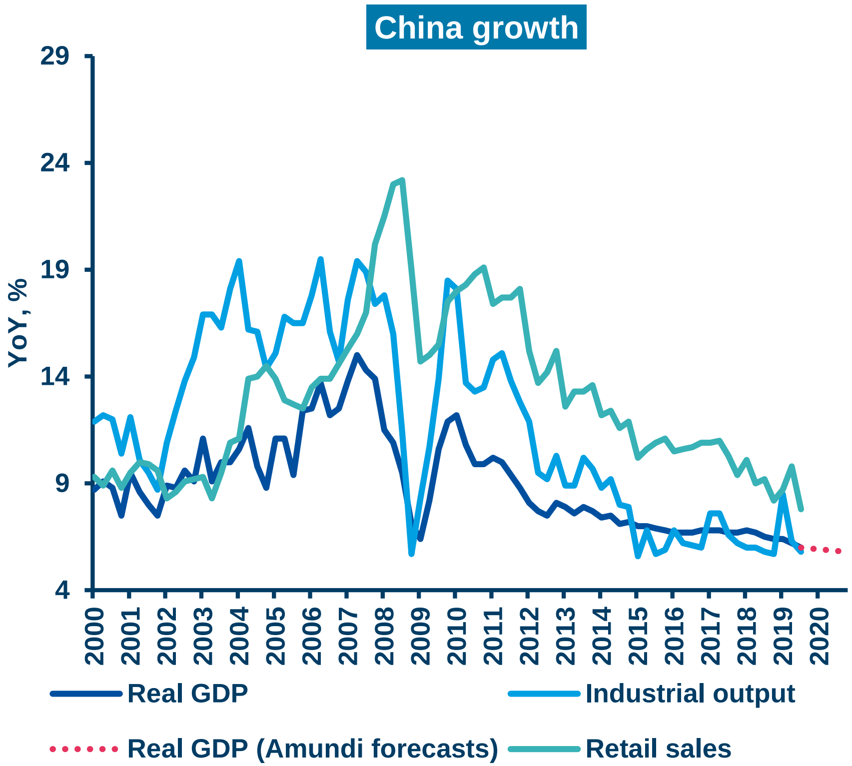
» Global and domestic drivers have given EM central banks very good reasons to lower official rates as a way of sustaining growth without triggering an exodus of capital. We think further easing is very likely over the coming months, especially from CBs in countries that have not been stimulating enough given their economic potential.

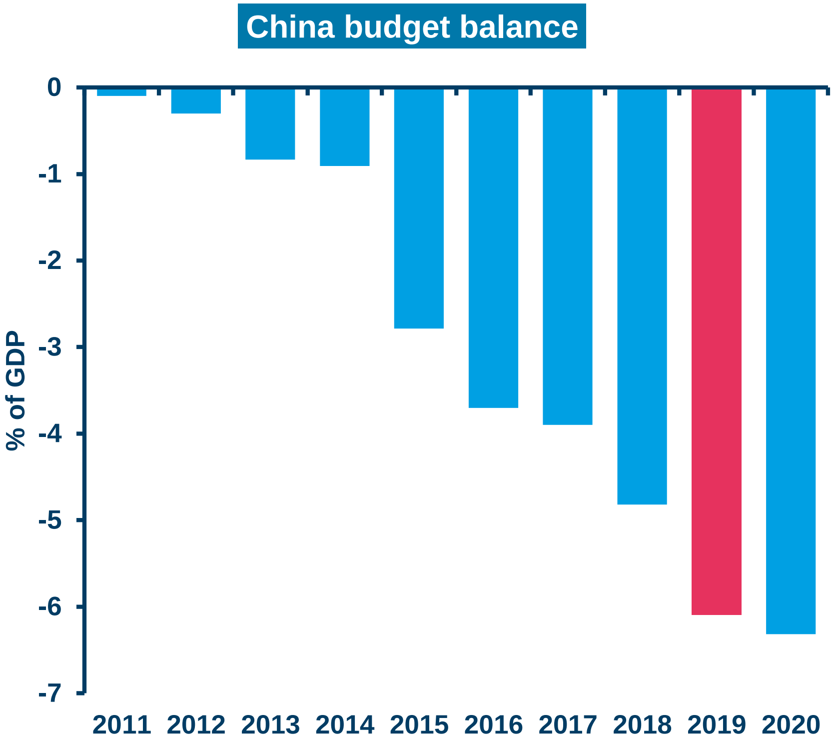
Source: Amundi elaboration on Bloomberg data. As of 15 October 2019. Balance sheets for Fed, ECB, BoJ and BPoC.

Source: Analysis by Amundi Research, CEIC. As of 4 October 2019.

Macro Themes
Equities
Fixed Income
Currencies

China's growth weakened, policy measures in support





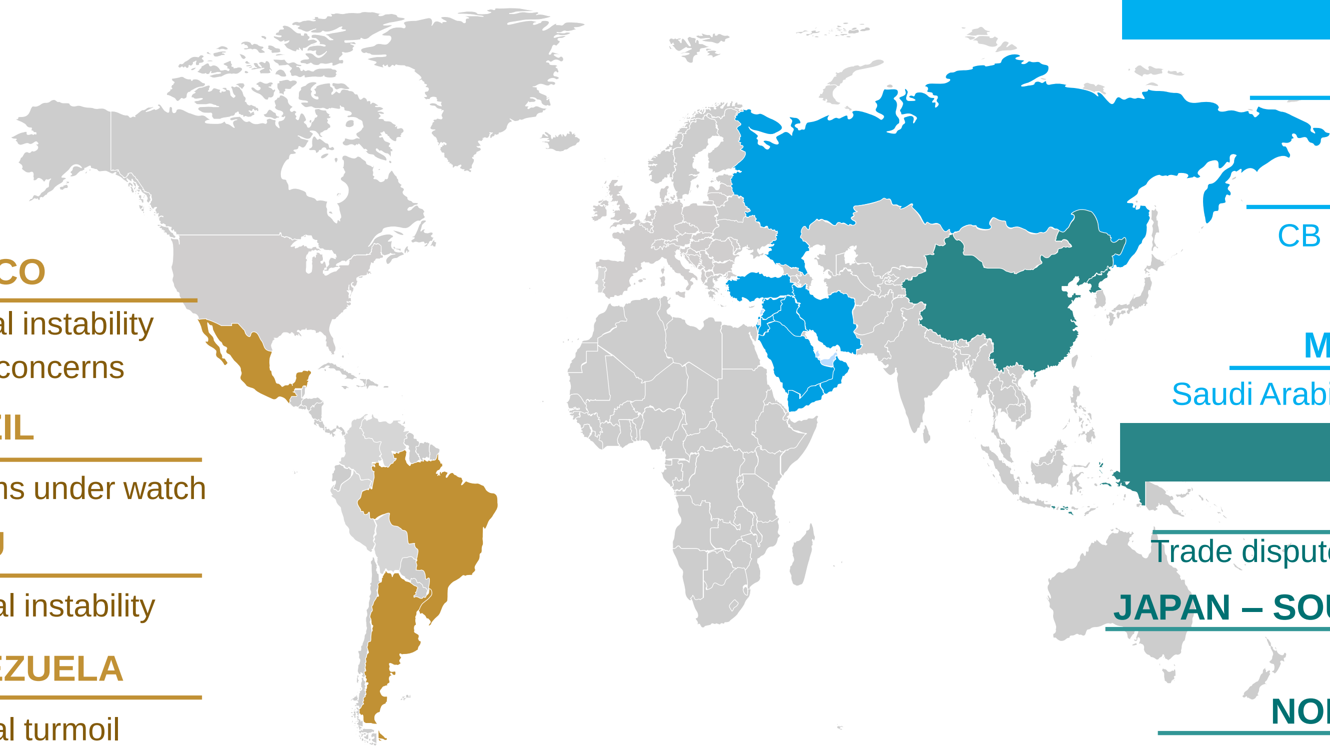
» China's economic growth has continued to slow and this may lead the government to provide further monetary and fiscal stimulus (already China rolled out tax cuts on personal income and corporate profits earlier this year). Stimulus initiatives and reforms are expected to produce growth stabilisation with further targeted measures.

Source: Amundi elaboration on National Bureau of Statistics data. As of 18 October 2019.

Budget balance is the overall difference between government revenues and spending. 2020 projections based on IMF assessment on current policies. Source: IMF Fiscal Monitor (October 2019), Amundi. Data as of 16 October 2019.

Amundi ASSET MANAGEMENT

Main (geo)political themes to watch moving into 2020



LATIN AMERICA

MEXICO
Political instability
Trade concerns

BRAZIL
Reforms under watch

PERU
Political instability

VENEZUELA
Political turmoil

EMEA

Russia
Sanctions

TURKEY
CB independence
US sanctions

MIDDLE EAST
Saudi Arabia-Iran tensions

ASIA

CHINA
Trade disputes with the US

JAPAN – SOUTH KOREA
Trade dispute

NORTH KOREA
Nuclear threats

Elections calendar

2019	October	December	2020	April	May	December
	Argentina Presidential Ukraine Parliamentary	Romania Presidential		Serbia Parliamentary	Poland Presidential	Venezuela Presidential

Source: Amundi. As of 25 October 2019.

Three key themes for EM equities

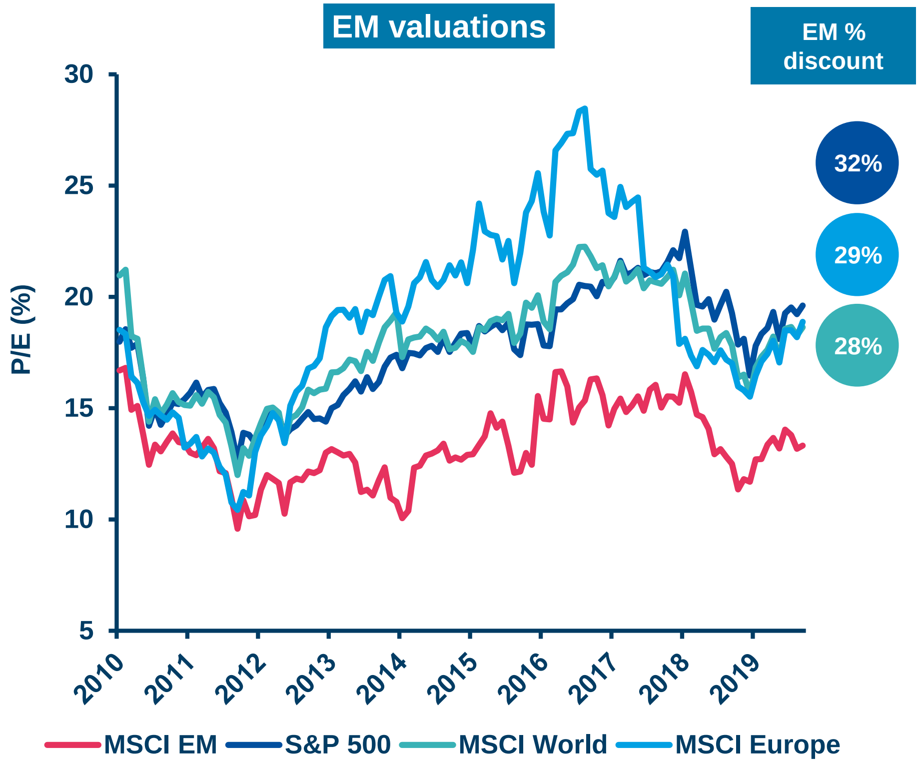
VALUATIONS — Attractive valuations (historically and vs. DM), decent earnings growth

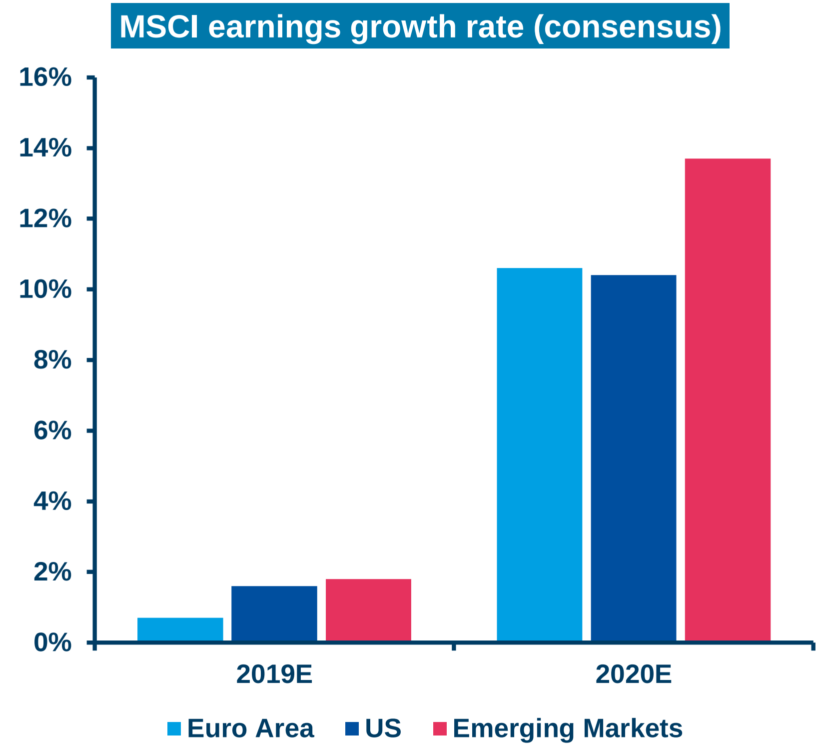
INCOME — Interesting dividend profile, a key theme to play in a late cycle

DOMESTIC FOCUS — Domestic consumption-oriented and services companies could better absorb the de-globalisation trend

Source: Amundi. As of 25 October 2019.

Valuations are attractive, earnings growth is decent



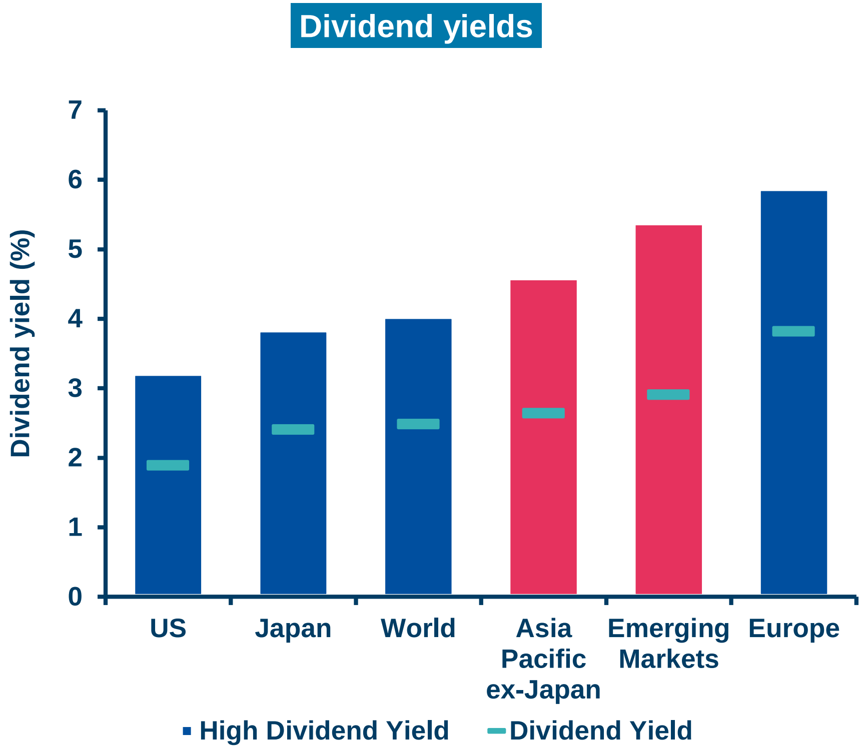


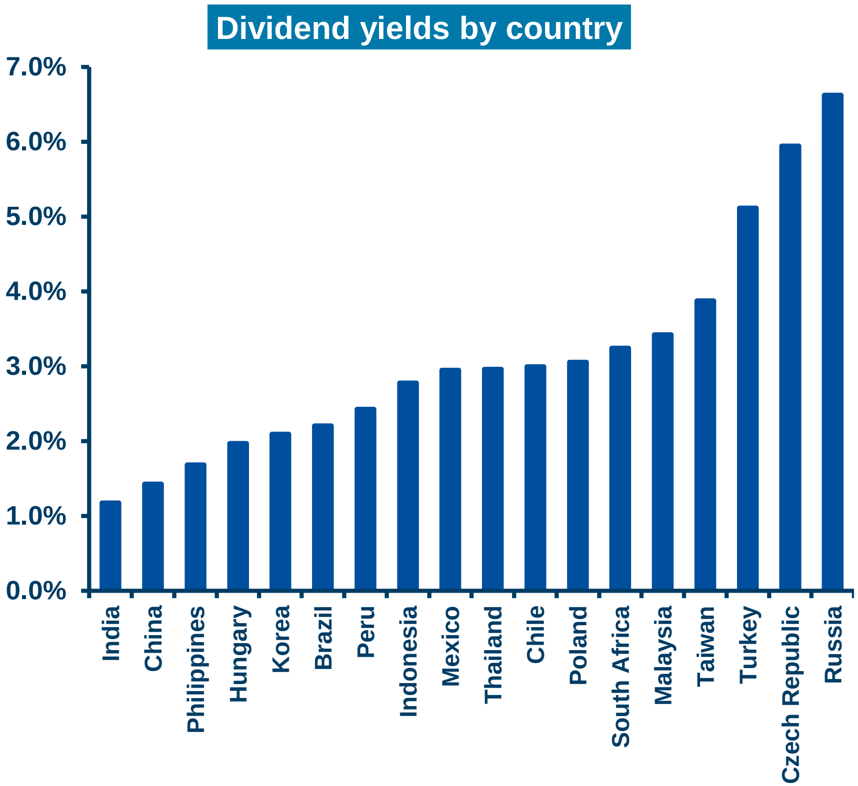
» From a valuation perspective, EM still look attractive both in absolute (historical) terms and compared with DM. Earnings in EM are expected to grow at a decent rate throughout 2020, but a focus on quality of earnings and sustainability of returns is key to maximising shareholder returns.

Source: Bloomberg, Amundi. Data as of 16 October 2019.

Source: Thomson Reuters IBES, Amundi elaborations. Data as of 16 October 2019.

Dividend yields are attractive, mind the sustainability





Improvements in corporate governance standards translate into attractive dividend payouts from EM companies compared with stocks in some major developed economies. However, stock selection remains key to identifying companies offering high dividend yields to shareholders.

Source: Bloomberg, Amundi elaborations. Data as of 21 October 2019.

Source: Analysis by Amundi Research on Datastream data. As of 23 October 2019.

Major investment convictions in EM equities

Favoured countries	Rationale
Russia	- Attractive valuations, fiscal boost next year, macro stabilisation policy working, sanctions partially priced in - Dividend yields remains very attractive - We favour tech companies and banks
India	- Macro-economic environment remains positive and political stability ensures continuity of reforms - Expansionary fiscal stimulus, corporate tax for new companies will boost earnings growth - We favour consumer discretionary, housing and financials
Indonesia	- Economic fundamentals look quite solid - Corporate and personal income taxes lowered to boost investments and demand - We favour domestic consumer and telecommunications
China	- Monetary and fiscal policies are expected to lift sentiment - Part of the concern related to trade wars seems to be priced in - We favour sustainable dividend yield companies, consumer discretionary, communication services and energy
Other countries	- Taiwan: technology stocks appeared to have bottomed and earnings growth is starting to turn around. We favour tech hardware and semi-conductors - Brazil: positive on reforms, cautious towards companies exposed to domestic growth

Source: Amundi. As of 23 October 2019.

Three key themes for EM bonds

SUPPORTIVE BACKDROP

Improved market sentiment on the back of still very loose monetary policies globally and anchored inflation

YIELD PREMIUM

Interesting yield premium, but focus on country fundamentals and vulnerabilitiesw

CURRENCY DYNAMICS

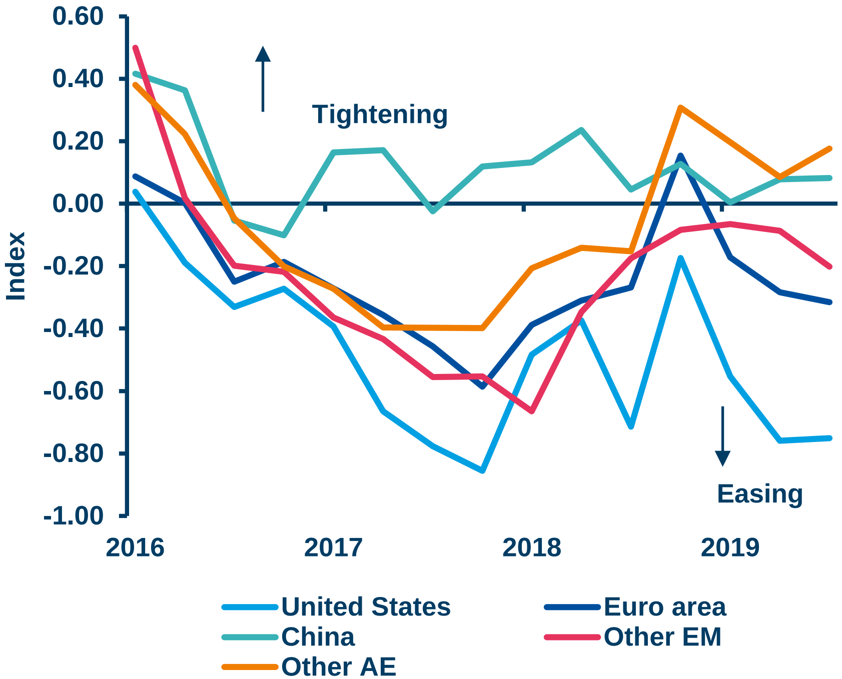
Sluggish growth is challenging for EM FX, but valuations are cheap and some tactical opportunities are emerging

Source: Amundi. As of 25 October 2019.

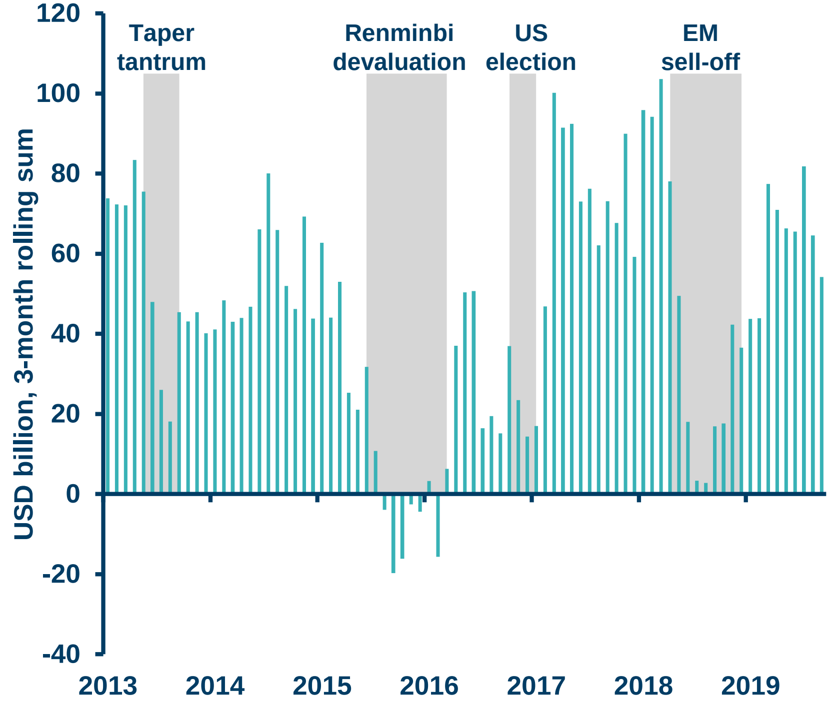
Macro Themes
Equities
Fixed Income
Currencies

External backdrop has helped support EM debt

Global financial conditions



Portfolio debt flows into emerging markets



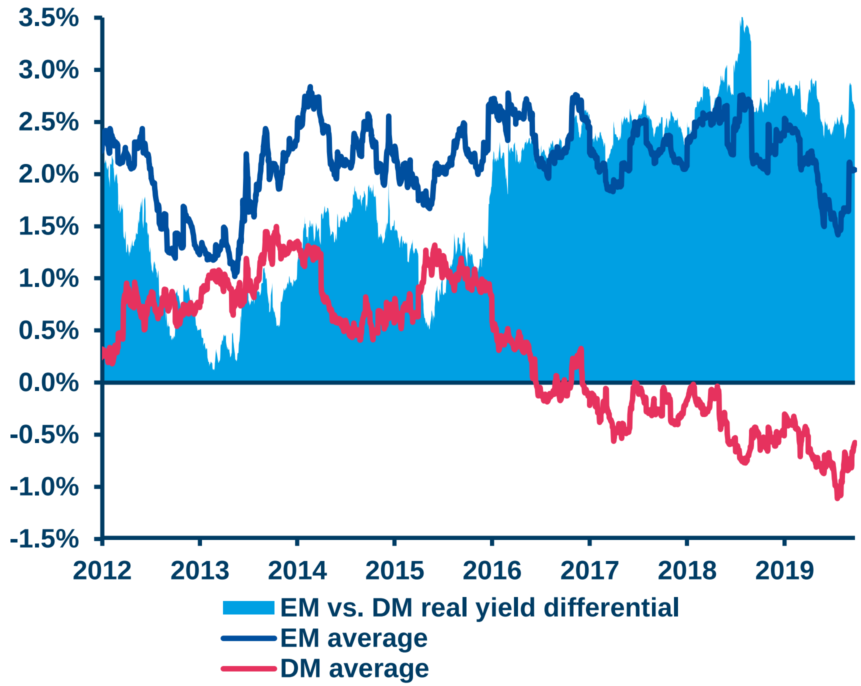
» The further easing in global financial conditions supported a rebound in portfolio debt flows to emerging markets, in particular higher yielding dollar-denominated bonds. Emerging market bonds may continue to benefit from the external backdrop of still very loose monetary policies globally, with about 30% of global bonds yielding sub zero.

AE: Advanced economies. Source: IMF Global Financial Stability Report, October 2019, Amundi. As of 21 October 2019.

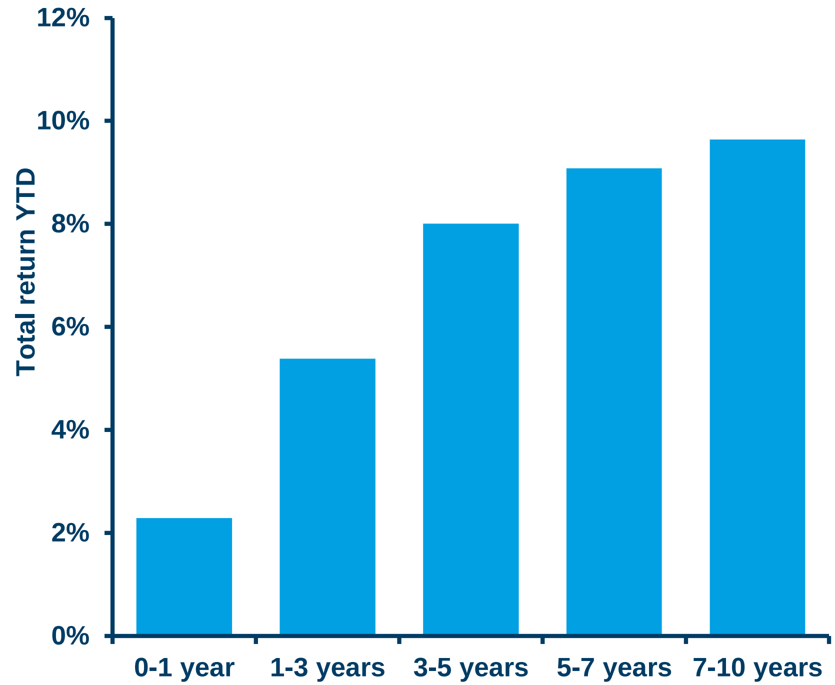
Source: National source, Bloomberg, IIF, Amundi. As of 3 October 2019.

EM bond yields are attractive

10Y real rates – EM vs. DM



Average returns per duration bucket



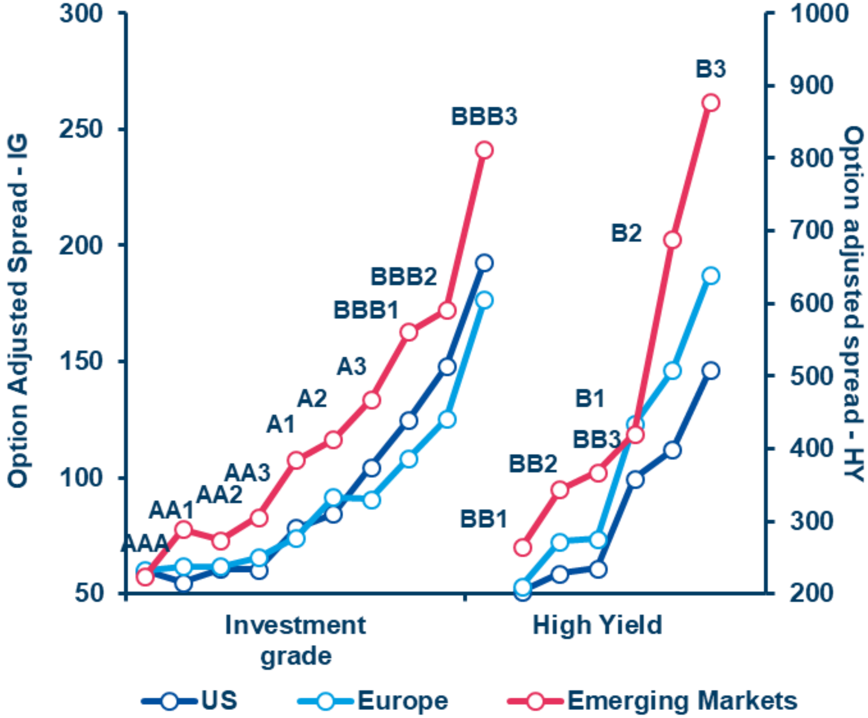
» Real rates are significantly higher in EM vs. DM. This element, combined with a dovish Fed, the possibly stable or weaker dollar and anchored inflation, is a key tailwind for EM debt. The dovish stance from central banks is favouring long-term duration bonds.

EM: Brazil, Chile, China, Colombia, Czech Rep., Hungary, India, Indonesia, Israel, Malaysia, Mexico, Philippines, Poland, Romania, Russia, South Africa, South Korea, Thailand, Turkey. DM: Australia, Canada, Eurozone, Japan, New Zealand, Norway, Sweden, Switzerland, UK,US. Source: Bloomberg, Amundi. Data as of 21 October 2019.

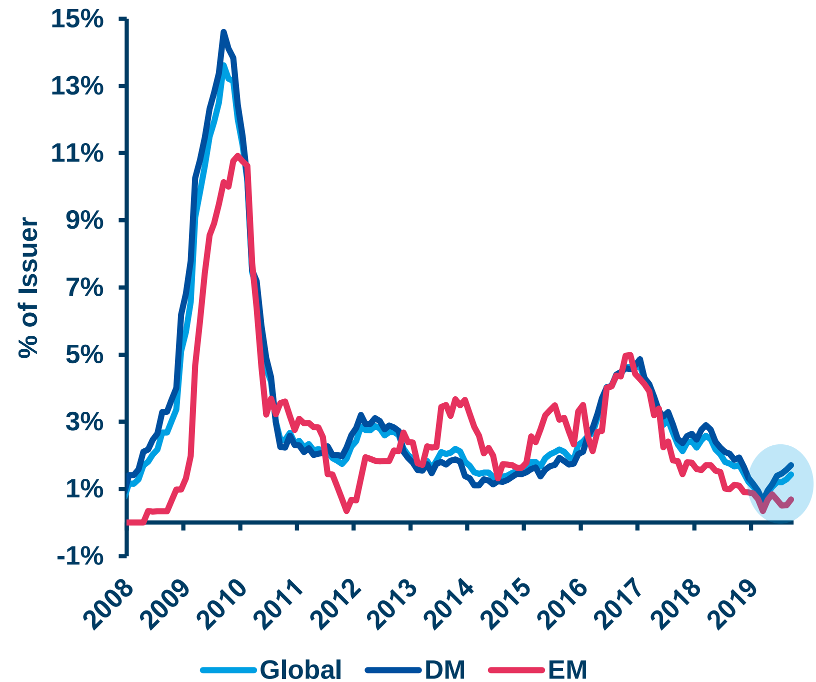
Returns are in US dollars. Based on the Bloomberg Barclays Global EM Local Currency Govt Index. Source: Amundi elaborations on Bloomberg data. As of 21 October 2019.

Solid fundamentals in EM corps, selective opportunities

Spread by class of rating



Corporate default rates

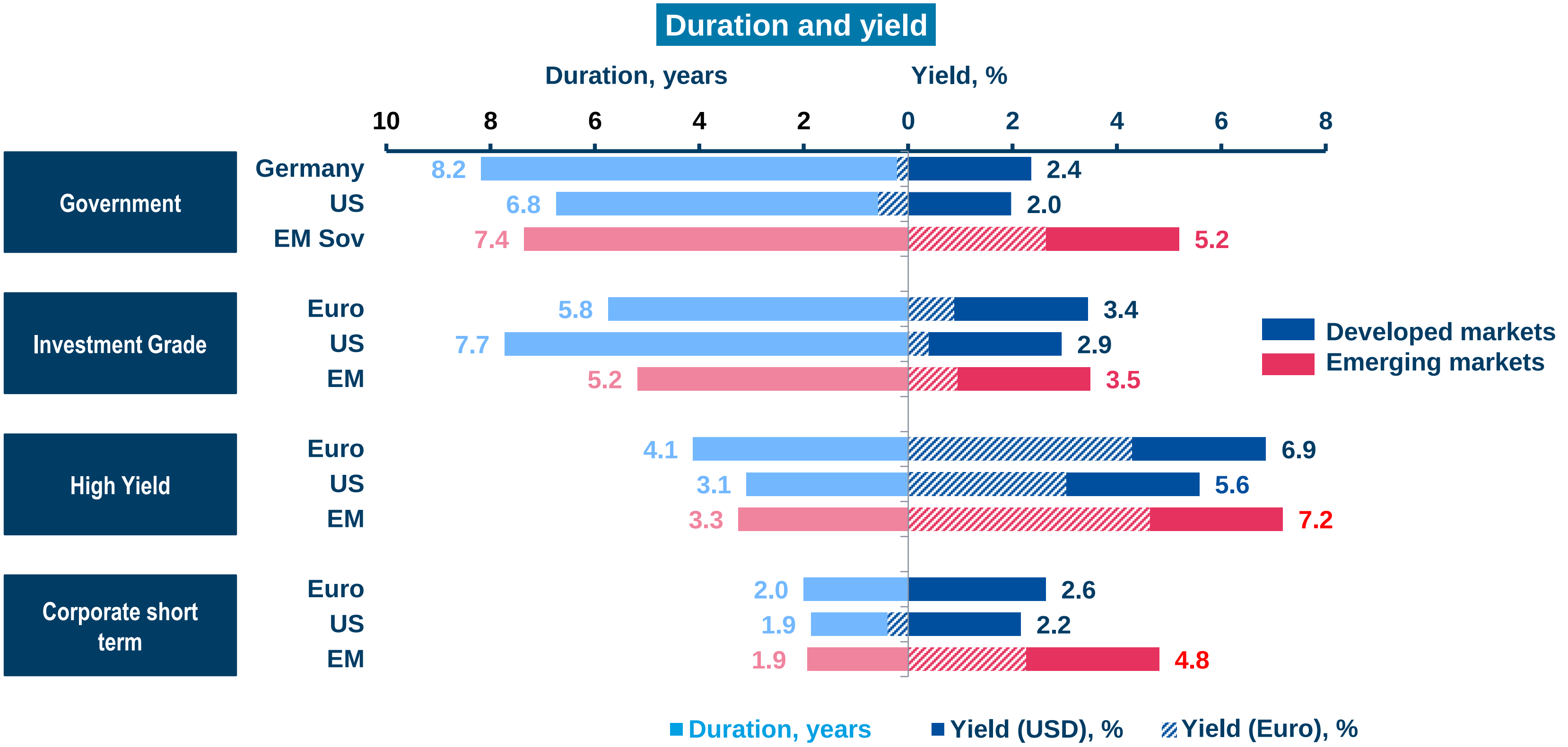


» EM corporate bonds provide relatively more attractive spreads than DM along the entire class of ratings (both IG and HY). EM corporate default rates have picked up slightly but remain low, with the high yield default risk lower than in DM. However, greater selectivity is needed as the risks to global growth have increased and market liquidity is scarce.

Source: Amundi elaborations on BofAML data. As of 21 October 2019.

Source: Amundi elaborations on BofAML data. As of 21 October 2019.

EM bonds offer ‘premium’, but selectivity is needed

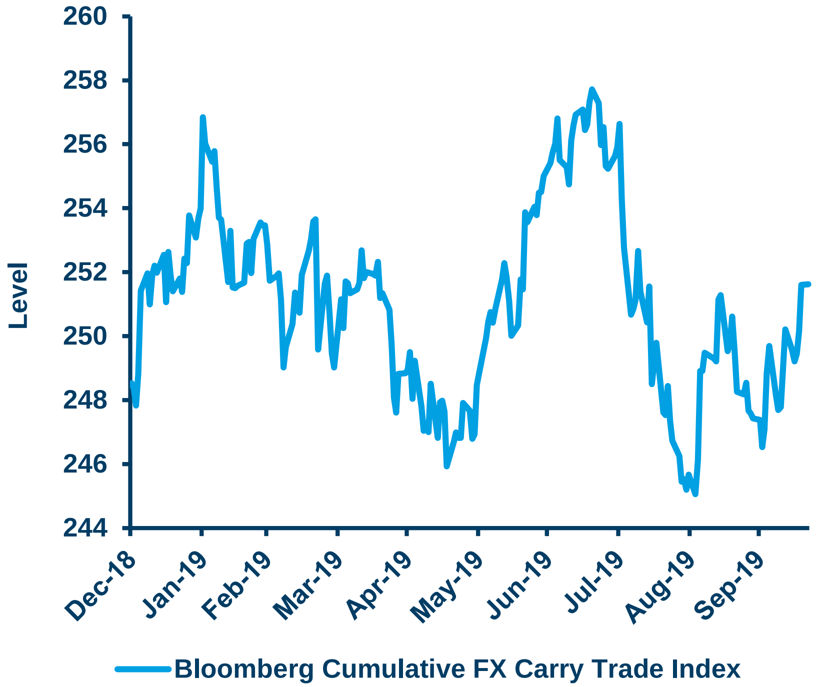


» Yield is rapidly evaporating in DM markets, leaving EM fixed income assets representing the yield oasis for fixed income investors.

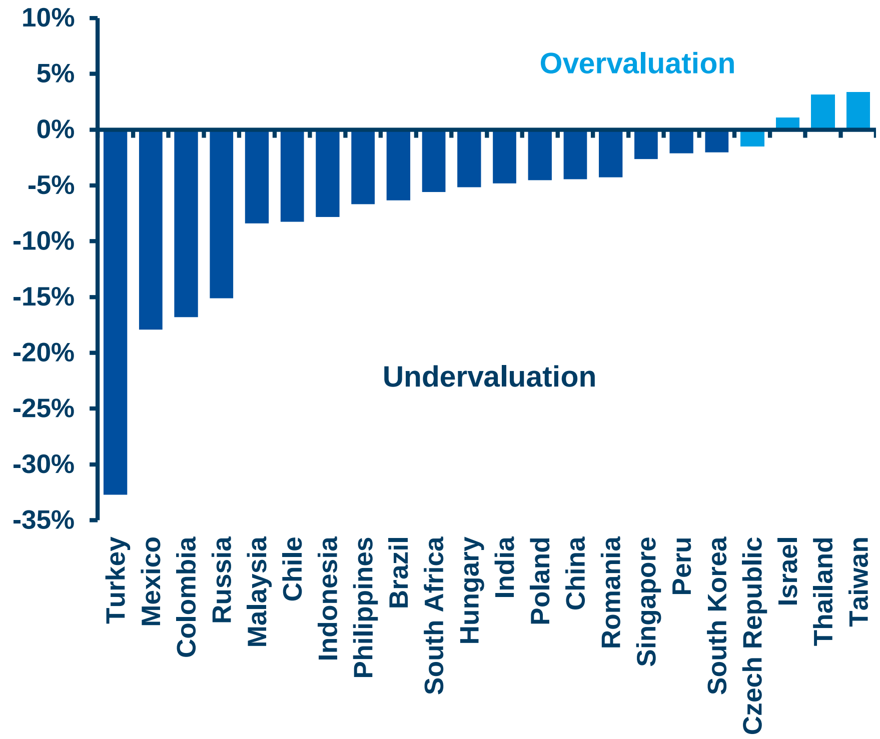
Yields for the USD- and euro-denominated indices have been computed by taking into account the USD and euro hedging costs. See notes at the end of this presentation for details of indices. Source: Amundi analysis on Bloomberg data. As of 22 October 2019. **Past performance is no guarantee of future results.**

Potential upside for local currencies, cautious in the short term

Emerging market FX carry trade



Medium-term fair value: valuation range



» The sluggish growth outlook suggests remaining cautious on EM FX in the short tem, although valuations remain cheap and some tactical opportunities are appearing from the EM carry comeback. The medium-term outlook for EM FX is more constructive and we see more value and potential for improvement going forward.

Source: Amundi elaborations on Bloomberg data. As at 21 October 2019.

Source: Amundi Research elaboration on Bloomberg data. As of 23 October 2019. Fair value calculated as an average of different measures (productivity, purchasing power parity, real effective exchange rate).

Macro Themes
Equities
Fixed Income
Currencies

Major investment convictions in EM bonds and FX

Favoured Countries	Rationale
Indonesia	- Positive on all asset classes (local and hard currency debt, corporates, FX) - Loosening monetary policy and inflation well within the target - Attractive valuations, solid fiscal balance. Preferred sector: utilities
Ukraine	- Positive on all asset classes (local and hard currency debt, corporates, FX) - Market-friendly government, opportunity for reforms. Technical support - Attractive carry. Preferred sectors: consumer, metals and mining, utilities
Serbia	- Positive on almost all asset classes (local and hard currency debt, FX) - Rating upgraded (solid fiscal discipline, decreased debt, improved market openness) - Higher carry than other peer countries in the Eastern Europe region
Brazil	- Positive mainly on corporates (tactically). Less positive on local bonds and FX - Positive reform momentum. Loosening monetary policy. Technically supported - Preferred sectors: oil producers, utilities, financials, food, pulp and paper
Other countries	- Russia: positive mainly on local debt (macroeconomic fundamentals remain strong) - South Africa: positive mainly on hard currency debt (attractive valuations, we see value in long end; Moody's rating downgrade less likely this year)

Source: Amundi. As of 23 October 2019.

Key takeaways

	EMERGING MARKETS	
	EM EQUITIES	**EM BONDS**
KEY THEMES	- **Valuations** - **Income** - **Domestic focus / regional themes**	- **Supportive backdrop** - **Yield premium** - **Currency dynamics**
HOW TO PLAY?	- **Global**: diversified and selective approach, with focus on domestic growth drivers - **Asia**: valuations and fundamentals, trade risk constantly monitored - **Latin America**: resilient growth stories, political stability and reforms - **CEMEA:** reasonable valuations and solid earnings outlook	- **Hard currency bonds:** attractive carry, better risk-return balance, support from strong liquidity measures by central banks - **Aggregate**: opportunity and diversification enhancement - **Corporates**: improved valuations, attractive premium, benign default cycle, positive technical momentum

Source: Amundi. As of 23 October 2019.

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ASSET MANAGEMENT

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Recent EM Publications

Available at the Amundi Research Center: http://research-center.amundi.com/

Date	Title
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14 August 19	Argentina: election surprise amplifies market and political risks
07 August 2019	US-China trade war: walking a tightrope
1 July 19	How to differentiate emerging countries? New approaches for classification and typology
12 June 19	Investing in the changing shape of Emerging Markets
25 June 19	Turkey: inflation, exchange rate's pass-through and monetary policy
29 May 19	Indian elections: political continuity is positive but reform is what matters most

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Indexes reference & definition

Bond Indexes (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 Indexes (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 Indexes

German Govt Bonds = JP Morgan GBI Germany Index; U.S. Govt Bonds = JPMorgan GBI U.S. Index; Euro IG Bonds = Bloomberg Barclays Pan European Aggregate Corporate; U.S. IG Bonds = Bloomberg Barclays U.S. Aggregate Credit; Euro HY bonds = Bloomberg Barclays Pan-European High Yield ISMA; U.S. HY Bonds = Bloomberg Barclays U.S. 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; U.S. Corp Short Term = Bloomberg Barclays U.S. Corporate 1-3Yr; EMBI Short Term = JPMorgan EMBIG Diversified 1-3Yr.

Definitions

- Basis points: one basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- 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.
- 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.
- FX: FX markets refer to the foreign exchange markets where participants are able to buy and sell currencies.
- 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.

Important Information

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