IMPERIUM CAPITAL

momentum

Emerging Opportunities

Global Matters Weekly

1 February 2021

– **Stephen Nguyen, CFA**

2020 witnessed some of the toughest challenges – be it social, economic or political – that most of us have ever experienced. Around this time 12 months ago, the Covid-19 pandemic was gathering momentum, particularly in Asia before it spread further afield, and soon enough the world went into lockdown. As we slowly emerge from the shadow of the pandemic thanks to vaccine breakthroughs, mobility and global economic growth should gradually increase. Emerging markets (EM), led by the Asian powerhouses (primarily China, South Korea and Taiwan), are likely to lead the recovery helped both by them being the engine of global growth but also having managed the pandemic better than peers. Emerging markets outperformed global developed equities in 2020 for the first time in three years: could this be a sign of things to come?

The evolution of emerging markets has been significant over the past few decades, creating a much broader set of potential opportunities for investors. Both equity and debt markets have become much broader and deeper and EM indexes more diverse, thereby creating a much richer and more robust opportunity set. There are many other dynamics that emerging markets can benefit from, such as the growth of the middle class, advances in technology and improving corporate governance, which together are likely to encourage more flows into the region.

In the current low growth world, emerging markets offer much promise relative to their developed market peers. GDP growth is likely to outpace that in developed markets, particularly within the Asian region.

With eye-popping valuations in some parts of the US equity market, the question we receive from many investors is, are there any bargains to be had? We believe there are pockets of value such as cyclical areas of the market (traditional value stocks) which still have significant upside from here. Emerging market equities represent another area with exciting return potential as valuations are still reasonable despite strong performance in recent months. Solid and improving fundamentals led by the Asian countries (which account for almost 75% of the MSCI EM index), along with an increasingly positive focus on ESG issues and supportive flows into the regions, together produce a bright picture for emerging markets in the years ahead.

In the current environment of low to negative yields in much of developed bond markets, investors with a focus on income would be wise to look further afield, with emerging market debt (both hard and local currency) offering a decent yield premium. This yield advantage should help to insulate emerging market bonds from rising bond yields elsewhere should global growth recover as anticipated. Whilst spreads relative to US Treasuries have tightened significantly, we believe there is room for more compression as global economies recover. The potential for a weaker US dollar provides another tailwind for the asset class.

We see a rotation into value sectors and regions as offering the best longer term recovery potential, and emerging markets today merit increasing attention as part of your overall portfolio construct

Exposure to emerging markets adds diversification, as it generally an anti-dollar trade which serves to balance the bias most portfolios exhibit as a result of owning dollar rich assets in the form of treasuries and stocks.

So how can we tap into this potentially faster growing and higher yielding region? Whether you are considering stocks or bonds, emerging markets offer a compelling opportunity as the global economy recovers. The next decision is to take the “active” or “passive” route: whether to buy a cheap passive fund or seek out the expertise of an active manager. I think there are plausible arguments on both sides, however emerging market exposure is not without risk. As with any investment, this selection choice and associated risk is best mitigated with thorough due diligence by a specialist investment team and combining this with a strong and robust portfolio construction process.

We are aware of the many risks that lie ahead, not least the roll-out and efficacy of vaccines and their availability to people living in emerging markets who are the engine behind this growth. We are very mindful of the strong gains delivered by risk assets in recent months leading to elevated valuation in some parts of the broader market. However, we see a rotation into value sectors and regions as offering the best longer term recovery potential, and emerging markets today merit increasing attention as part of your overall portfolio construct.

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The Marketplace

- Global equities fell -3.4% last week
- The IMF revised their global growth forecast for 2021 from 5.2% to 5.5%
- Brent crude rose 0.8% last week to $55.9 a barrel
- Gold fell -0.4% to $1847.65 per ounce

Market Focus

US

- US equities fell -3.3% last week
- It was a week of extraordinary volatility in some stocks targeted by retail investors bidding up the prices of several heavily shorted companies
- The services and manufacturing PMIs both beat expectations at 57.5 and 59.1 respectively, leaving the composite at 58 for December, slightly below November's level
- The Conference Board's consumer confidence reading rose to 89.3 for January, against 89.0 expected
- Durable goods orders in December rose by 0.2% against a 1.0% rise expected
- Weekly jobless claims in the week to 23rd January fell to 847k against 875k expected
- Continuing jobless claims fell to their lowest level since the pandemic began in the week to 16th January
- GDP in Q4 grew at an annualised rate of 4.0% against 4.2% expected, meaning that GDP contracted by -3.5% in 2020 as a whole.

UK

- UK equities fell -4.3% last week
- The UK's composite PMI came in at 40.6 against 45.5 expected for the flash January figure, as the services PMIs read 38.8 (vs. 45.0)
- The unemployment rate for the three months to November rose to 5.0%, its highest level in over four years, with the redundancy rate also increasing
- PM Johnson announced that schools in England would not be returning after the February half-term break, instead reopening hopefully from 8th March.

Europe

- European equities fell -3.1% last week
- The flash composite Euro Area PMI for January fell to 47.5, indicating there was a contraction in activity
- Germany's composite flash PMI was 50.8 against 50.0 expected, whereas France read 47.0 (vs. 49.0 expected)
- Italian Prime Minister Conte resigned after losing a parliamentary majority, paving the way for either a new coalition or snap elections
- The EU was involved in a row with both the UK and AstraZeneca amid supply problems of the covid-19 vaccine and the EU Commission's subsequent threat to block vaccine exports to the UK, which it later stepped back from
- Germany cut their 2021 growth forecast from 4.4% to 3.0%
- Spanish GDP rose 0.4%, above the -1.4% contraction expected, while France's GDP fell -1.3% against -4.0% expected in Q4.

Asia/Rest of The World

- The benchmark Global Emerging Markets index returned -4.5% last week
- Japanese equities fell -2.6% in the week
- The People's Bank of China governor said that the country's monetary policy will continue to "prop up the economy", while remaining mindful of risks
- Japan's leading news outlet has reported the country is considering extending its state of emergency from 7th February to the end of the month.

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 29 Jan. 2021	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	-3.3%	-1.0%	-1.0%	14.9%
United Kingdom	GBP	-4.3%	-0.7%	-0.7%	-13.2%
Continental Europe	EUR	-3.1%	-1.1%	-1.1%	-0.7%
Japan	JPY	-2.6%	0.2%	0.2%	9.0%
Asia Pacific (ex Japan)	USD	-4.6%	3.5%	3.5%	27.8%
Australia	AUD	-2.8%	0.3%	0.3%	-3.3%
Global	USD	-3.4%	-1.0%	-1.0%	14.0%
Emerging markets equities					
Emerging Europe	USD	-3.1%	-2.3%	-2.3%	-13.9%
Emerging Asia	USD	-4.9%	4.3%	4.3%	35.3%
Emerging Latin America	USD	-3.5%	-6.7%	-6.7%	-17.2%
BRICs	USD	-4.1%	3.8%	3.8%	24.1%
China	USD	-4.0%	7.4%	7.4%	41.7%
MENA countries	USD	-0.6%	2.9%	2.9%	1.6%
South Africa	USD	-1.4%	2.7%	2.7%	4.5%
India	USD	-5.0%	-2.2%	-2.2%	11.2%
Global emerging markets	USD	-4.5%	3.1%	3.1%	23.8%
Bonds					
US Treasuries	USD	0.0%	-1.2%	-1.2%	4.9%
US Treasuries (inflation protected)	USD	0.2%	0.3%	0.3%	9.9%
US Corporate (investment grade)	USD	-0.1%	-1.3%	-1.3%	6.2%
US High Yield	USD	-0.1%	0.3%	0.3%	7.2%
UK Gilts	GBP	0.0%	-1.7%	-1.7%	3.1%
UK Corporate (investment grade)	GBP	-0.3%	-1.2%	-1.2%	4.7%
Euro Government Bonds	EUR	0.2%	-0.6%	-0.6%	2.3%
Euro Corporate (investment grade)	EUR	-0.2%	-0.1%	-0.1%	1.7%
Euro High Yield	EUR	-0.3%	0.4%	0.4%	2.4%
Japanese Government	JPY	-0.1%	-0.3%	-0.3%	-1.6%
Australian Government	AUD	0.0%	-0.7%	-0.7%	1.0%
Global Government Bonds	USD	-0.2%	-1.3%	-1.3%	7.1%
Global Bonds	USD	-0.1%	-1.0%	-1.0%	7.5%
Global Convertible Bonds	USD	-1.9%	0.0%	0.0%	23.2%
Emerging Market Bonds	USD	0.1%	-1.8%	-1.8%	3.3%

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Asset Class/Region	Currency	Currency returns			
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Property					
US Property Securities	USD	-0.8%	0.1%	0.1%	-10.7%
Australian Property Securities	AUD	-1.7%	-4.1%	-4.1%	-17.0%
Asia Property Securities	USD	-1.5%	-0.1%	-0.1%	-8.7%
Global Property Securities	USD	-1.0%	-1.0%	-1.0%	-8.5%
Currencies					
Euro	USD	-0.3%	-0.8%	-0.8%	10.2%
UK Pound Sterling	USD	0.2%	0.4%	0.4%	5.3%
Japanese Yen	USD	-0.8%	-1.3%	-1.3%	4.3%
Australian Dollar	USD	-0.9%	-0.7%	-0.7%	13.3%
South African Rand	USD	-0.6%	-3.5%	-3.5%	-3.7%
Swiss Franc	USD	-0.5%	-0.6%	-0.6%	9.5%
Chinese Yuan	USD	0.8%	1.5%	1.5%	7.5%
Commodities & Alternatives					
Commodities	USD	1.1%	4.2%	4.2%	2.2%
Agricultural Commodities	USD	2.9%	4.8%	4.8%	24.4%
Oil	USD	0.8%	7.9%	7.9%	-6.6%
Gold	USD	-0.4%	-2.5%	-2.5%	17.6%
Hedge funds	USD	-1.2%	0.1%	0.1%	5.9%

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Important notes