Heartwood
Investment Management

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Investment Insight

Weekly Insight

After a challenging summer, what next for emerging markets?

Faced with the unholy trinity of a stronger US dollar, higher US Treasury yields, and still unfolding tariff wars between the US and China, investors flooded out of emerging market assets over the summer. With investor sentiment shaken, both debt and equities have been punished.

In the past few weeks, concerns around specific 'problem children' like Argentina and Turkey have crossed into other markets, and with emerging market currencies weakened against the strengthening dollar, the cost of servicing and issuing debt has risen for these countries. The dollar recently paused for breath following its stellar run, but remains strong versus emerging market currencies.

US protectionism remains a sticking point

Broadly speaking, the pressures placed upon emerging markets in recent months could remain in situ for some time. For emerging markets to truly rebound, investors need to witness an easing of trade tensions, which is not in keeping with President Trump's current protectionist stance.

Indeed, ahead of the November mid-term elections, the White House is likely to maintain its protectionist agenda at home, where it is well received by Trump's electoral base. The situation is exacerbated by monetary policy tightening by the US Federal Reserve, which has raised interest rates three times this year so far. Chair Jerome Powell this week reiterated that as a policymaker he remains exclusively focused on his domestic economy.

Against this backdrop, emerging market policymakers are taking action. In Turkey, the central bank recently defied President Erdogan with a surprisingly large rate hike in an effort to stabilise the lira, while the Russian central bank also nudged rates higher. Although proactivity is to be applauded, policymakers in embattled emerging markets must be careful to avoid damaging their domestic economies.

Signs of encouragement

On the heels of a challenging summer, we see plenty of reasons to remain optimistic about the emerging market investment space.

First, investors should be aware of significant performance and policy divergences between different emerging markets. For example, we initiated a position in the Chinese domestic market in July, perceiving a possible buying opportunity amid the introduction of a series of growth positive policies. We also have selective exposure to emerging market debt.

Second, while the buoyant earnings-per-share growth witnessed in the first half of the year (particularly in Asia) has given way to lower revisions in the last couple of months, positive earnings growth is expected across all sectors for 2018 as a whole.

And thirdly, emerging markets are fundamentally more robust versus previous crises. The current environment is a world away from the run up to the late 1990s, and indeed five years ago, with aggregate current account positions, foreign exchange reserves and overseas bank claims all in markedly better shape. Ahead, investment markets will be looking for convincing and pragmatic emerging market policymakers.

Separating the wheat from the chaff, then, we believe that selective emerging markets exposure continues to offer attractive long-term investment potential.

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Clear Thinking

Contact

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