CITY OF LONDON
Investment Management Company Limited

# Emerging Markets Quarterly Outlook

**January 2019***

## Overview

### A Year to Forget, A Year to Look Ahead to

Following a stellar 2017, emerging market (EM) equities transformed into the worst performing asset class in 2018 (the sub-category of industrial metals aside), going from a 37% return in one year to a 15% loss the next. After an initial market sell-off in February, a sharp correction across all asset classes in October was followed by a brutal market down-leg in December. To be sure, hardly any markets featured a positive return in 2018, the US dollar being a notable exception. Even the S&P500, which had been in positive territory for most of the year, eventually turned in a 5% loss, although this was still better than many of its peers in net total return (TR) USD terms (Euro Stoxx dropped by 16%, the Nikkei by 9% and the UK's FTSE 100 by 14%). Within emerging markets, the worst performing country was Turkey, which lost 41% on balance but staged a late-year recovery as the lira stabilised. However, from a systemic perspective, the 16% loss of Mexican equities and even more so the -28% return of Chinese equities (A-shares) is more important.

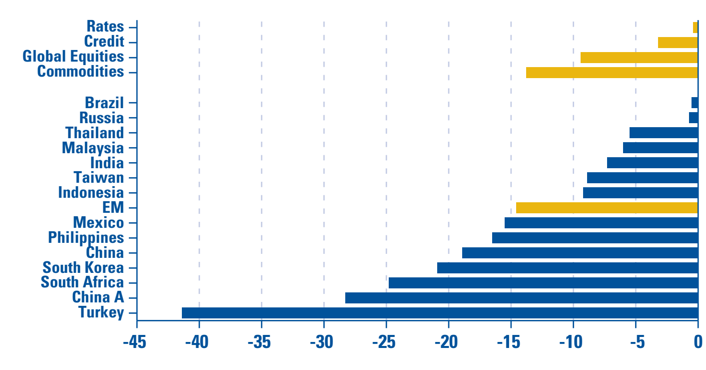
To some extent it appears that these market swings have decoupled from fundamentals, pricing in a catastrophic economic scenario that remains at odds with current incoming data. In turn, poor growth prospects quickly translate into other elements of the outlook as well, such as earnings growth and rate increases. Many have also pointed to the effects of rising trade tensions on growth. So correctly weighing up the factors responsible for the 2018 turnout should provide some useful guidance for what investors can expect in 2019.

Fears of a US recession have risen significantly. For instance, market-based recession models estimate the probability of a recession at 50% in the next 12 months. Yet, fundamentals-based models see such a chance at merely 30%, even if that is significantly higher than the 10-12% probability foreseen until recently. True, economic surprise indices have turned decidedly negative everywhere, including the US. Indeed, a recent PMI release in the US posted the largest monthly decline in a decade. But PMIs remain in expansionary territory, the labor market (including hiring intentions) is still strong and even a 30% chance of recession suggests an overwhelming probability of none. With a gradual cyclical slowdown thus more likely, it appears that markets are merely belatedly adjusting to the temporary nature of the economic boost induced by the tax cut, and are doing so in an exaggerated manner.

The corollary to a weaker expansion is a reduced pace of monetary tightening. Clearly, 2018 was not the year when the much-feared end-of-cycle inflationary shock reared its ugly head. The Fed already adjusted its plans for the year downwards, planning two instead of three rate hikes and maintaining a data-dependent posture. But market expectations have shifted from pricing in fewer than three rate hikes to pricing an actual cut in 2019. Yet, it is worth remembering that some of the recent financial tightening is doing the Fed's job for it and that adjustments in monetary policy will continue to adapt to variations in cyclical conditions. As for the pace of quantitative tightening (QT), it is unlikely to change, barring a radical shift in the outlook. Indeed, markets may be overestimating its effect: if QT mattered that much for asset prices, it would shift (real) long term interest rates radically upwards, which has not happened over the past year.

Trade tensions were one of the focal points for markets in 2018 and continue to be much feared and talked about. Yet, they have turned out to be less malicious than anticipated: new agreements were struck swiftly with Japan, Korea, the Eurozone and Mexico/Canada, mostly without much fanfare. As far as China is concerned, the issue is less about a largely irrelevant bilateral trade deficit than about a broader strategic competition with an emerging rival. The rivalry with China will not be resolved quickly, whether a new trade agreement is struck or not. A "truce" was called in December following the G-20 meeting and the US agreed to hold off from hiking tariffs for 90 days to give time for progress in the negotiations. As of early January, there were smoke signals that the two sides were making progress towards a new agreement. This would somewhat limit the downside for the Chinese currency in the year ahead, but either way Chinese export growth will likely moderate, while a rise in bilateral tensions remains a fact that markets will have to get used to.

#### Chart 1: 2018 EM and Asset Class Performance, Net TR, US$, %




*Source: Bloomberg*

A third issue, which is related to trade, but separate, is the growth outlook for China. It has been and remains undoubtedly on a decelerating trend. Markets are hoping for decisive offsetting measures from Chinese policymakers in the form of a renewed fiscal

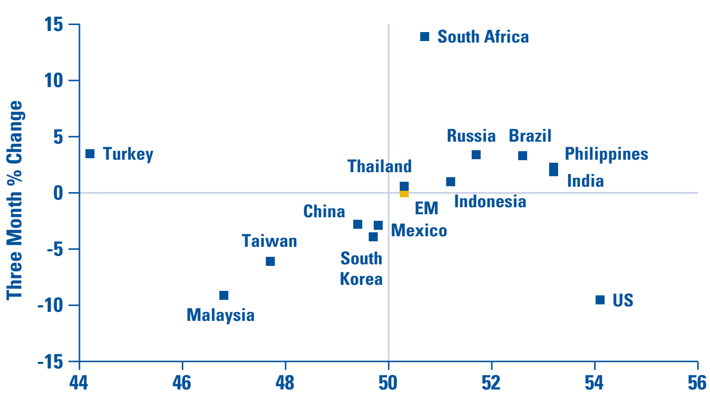
**The publication reflects asset performance up to December 31, 2018, and macro events and data releases up to January 11, 2019, unless indicated otherwise.*

stimulus. However, the deceleration in China is structural as the government seeks to shift the make-up of the economy and can at best be buffered. This, together with a government campaign against leverage in the financial system will likely continue to play a big role in slowing financial market gains. The other corollary to these developments is a weaker exchange rate and softer commodity prices as Chinese demand for raw materials eases (in particular those linked to construction).

Politics remain important for emerging markets, but not as pivotal as in 2018. In the case of India, the Bharatiya Janata Party (BJP) is expected to remain in power after the April/May elections, although in an enfeebled way as recent losses in key state elections suggest. In ASEAN, there are general elections in Thailand (February) and Indonesia (April). However, in both cases, the status quo is set to prevail. Opposition parties are faring well in polls in Thailand, but the military junta has put in place a voting system that is likely to see it retain a significant amount of power whatever the outcome. Indonesian President Jokowi and his party have a comfortable (15-20% point) lead in polls, again suggesting policy continuity. The political backdrop is thus less dramatic than a year ago when Brazil and Mexico both faced the prospect of electing leaders that would significantly alter the course of policy.

Meanwhile, equity earnings estimates for 2018 and 2019 have been significantly revised downwards across the world over the past few months due to these headwinds. Still, consensus expects 7.5% earnings growth for the US and around 8% growth for Europe and EM in 2019, according to J.P. Morgan and I/B/E/S. EM equities start to look more attractive as their forward P/E ratio of approximately 10 times is significantly lower than the 15 times for the US and the 12 times for Europe.

## Chart 2: Manufacturing PMI



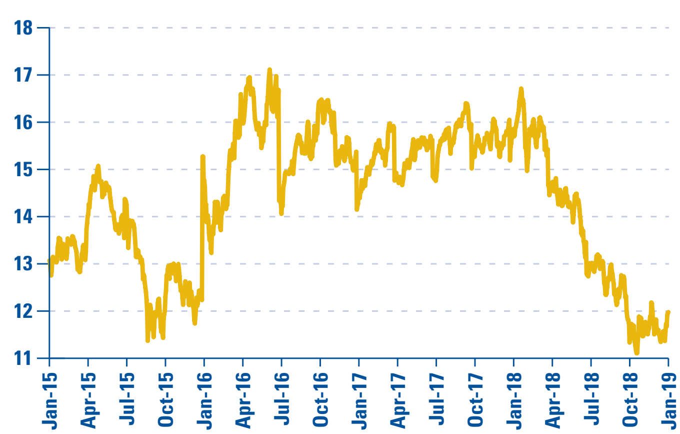

*Source: Bloomberg, Markit, Bureau for Economic Research, Institute for Supply Management*

## Market Strategy

Global economic momentum slowed in Q4, with manufacturing activity softening in particular. Inflation expectations also drifted lower, in line with weaker oil prices. That said, weaker economic performance is partly offset by a more supportive policy environment, including a slower pace of rate hikes by the Fed and greater policy stimulus in China. More importantly, country valuations diverged significantly as a result of market shifts and heightened volatility in Q4, which leads us to make the following changes to the country allocation:

- **Brazil**: Downgraded to *underweight*. Expectations for the Bolsonaro administration are high, but so are the hurdles for progress. Despite making the right noises on reforms, Bolsonaro's ability to negotiate and forge a consensus in a fractured Congress is untested. His party only has a small representation in Congress, so reforms are likely to prove difficult to pass. Yet, markets have priced in a best-case scenario.
- **India**: Downgraded to *underweight*. The resignation of the RBI Governor in December suggests the government is increasingly attempting to interfere with monetary policy. This is only likely to intensify as the general election in April/May approaches, while the risk of fiscal slippage is rising. Market valuations are elevated and look unattractive.
- We maintain *overweights* to **Russian** and **Mexican** equities as valuations have become much more attractive following the dislocations in Q4, while fiscal orthodoxy puts a ceiling on the country risk premium. In contrast, we remain *underweight* **Turkish** equities as the country moves from financial instability and rising inflation into recession. Finally, our *overweight* in **Korean** and **Taiwanese** equities coupled with an *underweight* in **Chinese** equities give us an opportunity to benefit from relatively cheap assets despite the uncertainty and noise of the Sino-US trade conflict.

## Chart 3: MSCI EM Trailing P/E




*Source: Bloomberg*

# Asia

## China

*Underweight*

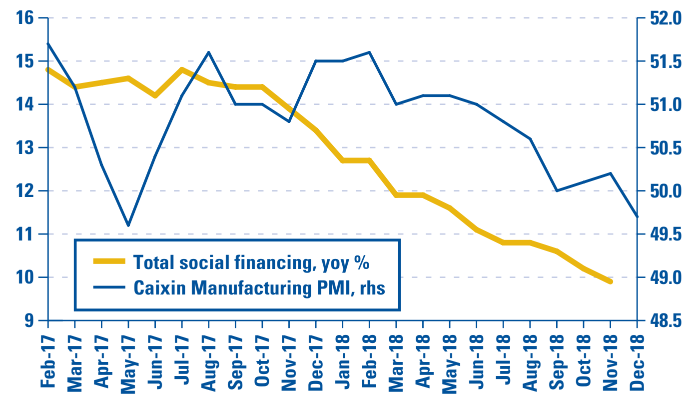
*The Chinese economy continues to slow and the market expects policy easing in 2019. Meanwhile, China and the US reached a temporary truce and resumed trade talks.*

China and the US reached a temporary trade truce after the two leaders met at the G20 summit in Argentina last December. The US announced a 25% tariff rate on $50bn of Chinese goods in August, followed by a 10% rate on another $200bn goods in September. The temporary truce – which is due to expire on March 1st - prevented the 10% rate from going up to 25% as initially scheduled for January 2019. Instead, the two sides resumed negotiations, hoping that they can reach a timely agreement so that the tariff rate will not increase again. The news of the temporary truce gave a lift to Chinese and global assets. It remains to be seen whether and what kind of deal can be reached by March as the agenda is set to go well beyond trade and cover a broad range of contentious issues, including forced technology transfer, intellectual property protection, non-tariff barriers and cyber theft.

GDP continued to moderate from 6.8% yoy in Q1, to 6.7% in Q2 and 6.5% in Q3. Q4 growth faces significant downside risks. Private consumption, the hitherto most resilient component of the economy, showed signs of weakness. Retail sales in November disappointed at 8.1% yoy, reaching a 15-year low, while passenger vehicle sales contracted compared to a year ago. Manufacturing activity felt the impact of the global growth slowdown. Industrial production grew by 5.4% yoy in November, the slowest in almost three years and below expectations, while industrial profits contracted 1.8% from a year ago. Manufacturing PMI fell into contractionary territory, to 49.7 in December, the lowest in 18 months. Fixed asset investment was somewhat better than expected, on the back of a pickup in public infrastructure spending as well as solid real estate investment. It grew by 5.9% yoy for the first eleven months of 2018, accelerating from 5.4% for the first ten months. More concerning, though, is that total social financing – a broad measure of credit – reached a historical low of 9.9% yoy in November, suggesting that the investment slowdown is likely to continue. Also, increased tariffs have begun to feed into the economy. Trade data in November came in substantially below expectations, with exports in USD terms decelerating to 5.4% yoy from 15.4% in October and imports falling to 3.0% from 21.4% in October.

Looking ahead, we think that policymakers will now prioritise supporting growth over addressing financial instabilities, a reversal from a year ago. They are likely to step up counter-cyclical macro policies, as suggested by the Central Economic Work Conference in December, which set out the economic tasks for the government in 2019. First, we expect a larger fiscal deficit with income tax and fee cuts, while local government borrowing is set to increase to fund infrastructure investment. Second, we expect several rounds of cuts in banks' required reserve ratios (RRR) as monetary easing continues. Indeed, the People's Bank of China (PBoC) announced a 100bps cut in RRR for all banks (as opposed to targeted cuts for certain banks in 2018) in the first week of January, earlier and more sizable than market expectations. Third, housing market regulation may loosen at the margin – particularly at the city level – as the conference downplayed the concern about a housing bubble and suggests regulation can be tailored city by city. Fourth, China also pledged to increase market access for foreign companies and improve intellectual property protection, apparently responding to demands made by the US. For instance, foreign companies may be allowed to enter more sectors with fully-owned subsidiaries.

### Chart 4: Chinese Credit and PMI




*Source: Bloomberg, The People's Bank of China, Markit*

Consensus expects 6.2% yoy growth in GDP for 2019, slowing from the 6.6% forecast in 2018 and 6.9% in 2017. The cyclical slowdown is expected to continue in H1 2019 as trade tensions and weak global demand continue to weigh on growth. H2 may see stabilisation in economic activity as policy easing feeds into the real economy, supporting credit, investment and private consumption. The Sino-US trade war remains the wild card. Its development will significantly influence the timing of the Chinese economic slowdown.

USDCNY has been extraordinarily stable since August – range bound between 6.8 and 7.0 – in contrast to the sharp RMB depreciation in June and July. Against the backdrop of escalating trade tensions and an economic slowdown, the PBoC and regulators have actively prevented the renminbi from rising above the 7.0 level. Going forward, the renminbi may face less depreciation pressure if the USD weakens as a result of the Fed slowing or pausing its rate hikes in 2019.

**Market Strategy**: MSCI China lost 10.7% in USD terms in Q4, underperforming EM equities by 3.3% points. The trailing P/E ratio of the MSCI China is similar to that of MSCI EM, compared to the five-year average of a 12% discount. We remain *underweight* Chinese equities as the cyclical slowdown has not shown signs of abating. That said, Chinese A shares, which have a trailing P/E similar to EM compared to a long-term average of 19% premium, provide better value. Increased fiscal and monetary stimuli may support A shares, which are more credit-sensitive than MSCI China.

## South Korea

*Overweight*

*Korean activity is set to marginally slow in 2019, but equities appear to have priced this in.*

Political tailwinds seem to have given way to economic headwinds in Q4. Negotiations with North Korea somewhat stalled following three successful summits between the two Koreas in Q2-Q3 as well as the first summit between the US and North Korea in June. The relief from the signing of the revised United States-Korea Free Trade Agreement in September was outweighed by the fear from the Sino-US trade war. The global manufacturing slowdown, as evidenced by the recent decline in global manufacturing PMIs, is likely to weigh on the Korean economy. Indeed, Korean exports unexpectedly contracted by 1.2% yoy in December after a 4.5% yoy gain in November. The downward surprise was partly due to a decline in semiconductor exports. Exports to China also disappointed and contracted by 13.9% yoy, while exports to other countries held up relatively well. Also, industrial production came in below expectations and contracted by 1.7% mom in November after a 1.3% gain in October. Therefore, there are downside risks to the consensus forecast of 0.7% quarterly growth in Q4, after the economy grew by 0.6% qoq in Q3.

Looking ahead, we think activity may remain weak in Q1 before recovering for the rest of 2019. Confidence remains fragile, with both consumer and business confidence indices falling to levels last seen in early 2017, indicating lacklustre activity in Q1. That said, the economy may pick up steam for the rest of the year as Chinese policy stimulus lends support to Chinese demand and hence Korean exports. Also, the Korean government recently proposed the largest increase in fiscal spending since the global financial crisis (9.7% yoy for 2019). It may also continue with tax credits and temporary tax cuts to support private demand as it did in 2018. Therefore, consensus expects 2.5% yoy GDP growth in 2019, similar to the 2.6% forecast for 2018.

Monetary conditions remain accommodative as the Bank of Korea continued its very gradual tightening cycle. The central bank hiked by 25bps in November 2017 and again in November 2018, bringing the base rate to 1.75%. The rate rises have largely been driven by financial stability concerns, i.e. high household debt and elevated house prices. Headline inflation dipped to 1.3% yoy in December from 2.0% in November due to softness in housing prices. Consensus expects at most one hike in 2019, as inflation remains under control.

**Market Strategy**: Korean equities lost 13.1% in USD terms in Q4, underperforming EM equities by 5.7% points. MSCI Korea trades at a trailing P/E ratio of 8, the lowest in 14 years. Its P/E ratio is at a 30% discount to the MSCI EM P/E, 0.9 of a standard deviation below the historical average. We remain *overweight* Korean equities as they seem to have mostly priced in the headwinds from trade tensions and the export slowdown.

## Taiwan

*Overweight*

*The market appears too pessimistic as valuations price a recession, which is unlikely in 2019.*

Local elections in November 2018 have significantly changed the political landscape in Taiwan. The Democratic Progressive Party (DPP), President Tsai's party was dealt a hefty defeat, including losing their long-term stronghold of Kaohsiung (the second largest city in Taiwan) to the Kuomintang (KMT). That is in sharp contrast to the DPP's overwhelming victory in the general election three years ago, reflecting voters' dissatisfaction with weak income growth and a lack of reforms. The comeback of the KMT, led by pro-business candidates like Han Kuo-yu in Kaohsiung who advocates increased business ties with China and attracting mainland tourists to Taiwan, suggests opportunities for improved cross-strait relations.

Meanwhile, Q3 GDP accelerated on a sequential basis, growing by 1.5% qoq saar (vs. 1.1% in Q2), or 2.3% yoy, due to a rebound in private investment and tech exports. However, Q4 growth faces downside risks as global manufacturing slowed and the tech cycle peaked. Total exports have contracted in year-on-year terms since November, with December exports falling 3.0%. However, the size of the contraction is marginally smaller than expected and partly due to base effects. Consensus estimates 2.7% growth for 2018, slightly higher than what was expected at the beginning of 2018.

Looking ahead to 2019, external headwinds may outweigh domestic policy support, leading to a moderation in GDP growth to approximately 2.3% yoy. First, exports to China/Hong Kong disappointed in 2018 and may continue to do so in Q1 2019 due to the Chinese economic slowdown and elevated trade tensions between China and the US. Second, tech exports may remain weak as Apple recently downgraded its sales forecast. However, partly offsetting the external headwinds is public investment – as the government continues to roll out its multi-year infrastructure program – and accommodative monetary conditions. Indeed, Taiwan's central bank kept its policy rate at 1.375% throughout 2018 despite four rate hikes by the Fed. The policy divergence between the two central banks did not induce a substantial depreciation of the TWD as Taiwan has large FX reserves and low inflation. Taiwan's central bank is expected to maintain its "moderately loose" policy stance and keep the key rate unchanged in 2019, with forecasts of 2019 inflation at 1.1%, from 1.4% in 2018.

**Market Strategy**: Taiwanese equities lost 13.7% in USD terms in Q4, underperforming EM equities by 6.2% points. MSCI Taiwan trades at a P/E ratio of 12 times, close to its 15-year low of 11.5 times and similar to the level in 2015 when Taiwan was experiencing a brief recession. Its trailing P/E is at a 4% premium to that of EM, in line with its five-year average. We remain *overweight* Taiwanese equities on the back of cheap valuations, a stable currency and accommodative central bank policies.

## Malaysia

*Underweight*

*Growth is likely to decelerate in 2019 as fiscal and monetary policy provide limited support.*

Malaysia's Q3 GDP disappointed: the economy slowed to 4.4% yoy from 5.2% in Q1 and 4.5% in Q2, underperforming consensus expectations. Private consumption remained resilient on the back of the removal of the GST following the election in May, but weak external demand weighed significantly on growth. The Latest data imply a further slowdown in manufacturing activity. For instance, the manufacturing PMI dropped to 46.8 in December, a historical low, due to a sharp deceleration in output and new orders. GDP growth for 2018 is likely to be around 4.7%, significantly lower than the 5.9% in 2017.

Looking ahead, economic growth may continue to moderate in 2019. First, policymakers are set to re-commit to fiscal discipline and fiscal policy may thus be less supportive than in 2018 when the removal of the GST widened the budget deficit significantly. Public investment may remain lacklustre, partly due to the cancellation of Chinese-backed projects. Second, Malaysia is an open economy, and exports may remain lacklustre given the Sino-US trade war. While there is anecdotal evidence that some businesses are adjusting their supply chains in response to the trade tensions and increasing capex in Malaysia, this needs to be considered within the broader context of weaker global demand due to trade frictions and higher production costs. Third, housing prices contracted in Q3 compared to a year ago, weighing on real estate investment. Consensus expects GDP growth of 4.6% in 2019, marginally lower than in 2018.

Headline CPI dipped to 0.2% yoy in November due to lower food and housing costs. However, core inflation continued to pick up from negative readings in Q3 to 0.5% in November. Inflation is expected to accelerate in 2019 on the back of a weaker ringgit and the reintroduction of the Sales and Services Tax (effective from September 2018). Consensus expects CPI inflation to accelerate to 2.2% in 2019, up from 1.1% in 2018. Therefore, the Malaysian central bank is likely to remain on hold in 2019 and maintain the policy rate at 3.25%. A rate cut would risk currency depreciation and financial instability given large foreign ownership of Malaysian debt.

**Market Strategy**: MSCI Malaysia lost 5.8% in USD terms in Q4. The index outperformed EM equities by 1.7% points, as defensive sectors (e.g. utilities, consumer staples and healthcare) constitute a large part of the Malaysian market. The trailing P/E ratio trades at a 59% premium over that of EM, two standard deviations above the long-term average of 27%. The relative valuation looks very unattractive given the slowing economy, trade slowdown and lack of monetary and fiscal stimulus. Therefore, we remain *underweight* Malaysian equities.

## Indonesia

*Neutral*

*President Jokowi is set to be re-elected amid healthy growth, low inflation and handouts to the poor.*

Q3 GDP in Indonesia decelerated marginally to 5.2% yoy from 5.3% in Q2, in line with expectations. Domestic demand supported growth, with government spending rising by 6.3% yoy and investment by 7.0%. Infrastructure build-out is set to remain growth supportive in 2019, albeit less so than in 2018 given that many projects are close to completion. Manufacturing PMI has remained in expansionary territory (51.2 in December), which should be positive for near-term growth. For full-year 2019, GDP is forecast to expand by 5.1%, down only slightly from the estimated 5.2% in 2018.

Inflation has remained under control, with headline CPI in a range of 2.9-3.4% yoy in 2018. Headline and core CPI both rose by 3.1% yoy in December. These figures are towards the lower end of Bank Indonesia's (BI) 2.5-4.5% target range for 2018. However, the Bank is more concerned about financial stability, and this explains its continued hawkish policy stance , leading it to raise its key rate by 25bps to 6.0% in November. The policy rate was raised by 175bps in all of 2018, with the aim of stabilising the rupiah. The policy appeared to work in Q4 as the currency strengthened against the US dollar in October and November, halving its year-to-date losses.

Policy has also been aimed at curbing imports and the current account deficit. The external shortfall widened to 2.8% of GDP in Q3, the largest since 2015. This is expected to narrow in 2019 to 2.6% of GDP, aided by the lower oil price and slowing infrastructure imports.

Presidential and legislative elections are scheduled for April 17th. Polls show that President Joko Widodo ("Jokowi") and his party (PDI-P) look likely to win as both have a 15-20% point lead over the closest rivals. Vice presidential candidate Ma'ruf Amin, a Muslim cleric, is also set to attract conservative voters. Jokowi is expected to raise spending, with cash handouts for the poor already earmarked over four phases for 2019, with the first two in January and April. He has also said electricity prices would be frozen and fuel subsidies would continue through end-2019. These populist policies are set to keep the budget deficit at around 2.0% of GDP this year, similar to that estimated for 2018.

**Market Strategy**: MSCI Indonesia had a strong Q4, outperforming EM by 17.2% points. However, valuations are now expensive. The trailing P/E is at a 46% premium to EM and two standard deviations above the long-term average. Also, ongoing external risks and twin deficits counterbalance strong growth and low inflation. Therefore, we remain *neutral.*

## Philippines

*Neutral*

*Growth is expected to remain robust, supported by falling inflation. However, external and fiscal deficits are set to remain wide.*

Economic activity has remained robust in the Philippines, growing by 6.1% yoy in Q3 and down only marginally from 6.2% in Q2. A government-led infrastructure build-out is set to support growth. Investment rose at a double-digit pace (16.7% yoy) for a third consecutive quarter, while government consumption growth accelerated to the fastest pace since 2015 (14.3%). This is set to support projected growth of 6.4% in 2019, against an estimated 6.3% in 2018. Downside risks remain amid business and consumer confidence at multi-year lows.

This comes against a backdrop of high and rising inflation, which rose to 6.7% yoy in October and more than double the outturn a year earlier. Indeed, the central bank (BSP) raised its key policy rate by 175bps in 2018, the most since 2000. These factors likely contributed to a slowdown in private consumption (70% of GDP) to 5.2% yoy in Q3, the slowest pace in four years. However, the outlook is more benign as inflation appears to have peaked at 6.7% yoy in November and fell to 5.1% in December. CPI is projected to rise by 4.1% this year, just above the upper bound of the central bank's 3-4% target. BSP's tightening cycle is thus likely close to concluding, which should aid growth this year.

The current account deficit is expected to remain around 1.5% of GDP this year, which is wide by historical standards (the 2017 shortfall of 0.8% was the first in 15 years). This is likely to be driven by robust imports of both infrastructure-related and consumer goods. Overseas remittances may also be hampered by slowing global growth. This is likely to keep downward pressure on the peso. However, a counterbalancing factor is the reform effort to improve the ease of doing business, which is attracting FDI (+31% yoy in the first eight months of 2018).

Midterm elections are set for May, which is likely to accelerate government spending. The budget deficit is projected to widen from an estimated 2.8% of GDP in 2018 to 3.0% in 2019. This year's budget is set to be approved by the Senate only in February and involves a 22.3% yoy rise in borrowing. Thus, the government's credit metrics are likely to deteriorate and this could raise financing costs.

**Market Strategy**: The trailing P/E of the MSCI Philippines is at a 67% premium over EM, which is 0.8 of a standard deviation above the long-term average. This is justified by the improved growth and inflation outlook. However, deteriorating fiscal metrics and a wide current account deficit pose downside risks for the peso. We stay *neutral*.

## Thailand

*Overweight*

*Growth is set to slow but should remain strong, while the general election is likely to lead to policy continuity.*

In what is likely to be a watershed moment five years after the military coup, Thailand is set to face a much-delayed general election on February 24th. General Prayut of the junta-backed Palang Pracharath Party appears likely to retain power though. Nevertheless, uncertainty is significant given that an estimated 15% of eligible voters will be voting for the first time in this election. According to recent polls, this could raise support for the opposition Pheu Thai Party, founded by former PM Thaksin Shinawatra. Either outcome is likely to lead to policy continuity, but uncertainty could weigh on sentiment in Q1.

Economic growth in Thailand slowed to 3.3% yoy in Q3, the slowest pace since Q4 2016. This was driven by a marginal contraction in exports (-0.1% yoy) compared to a 10.7% rise in imports. However, domestic demand remained healthy as expansions in private consumption (5.0% yoy) and investment (3.9%) accelerated. Manufacturing PMI also moved back up into expansionary territory in December, which may augur well for growth in early 2019. Overall though, consensus forecasts GDP growth for full-year 2019 to slow to 3.9% yoy from 4.2% in 2018. Activity is set to be supported by continued investment in and development of the Eastern Economic Corridor, an economic zone aimed at improving connectivity and supporting manufacturing.

Inflation has remained low and was below the Bank of Thailand's (BoT) 1-4% target range in November (0.4% yoy). However, given three years of low rates, elevated household debt (78% of GDP) and external risks, the Bank has become increasingly concerned about both the build-up of financial imbalances and the need to create room for easing due to, for example, an external shock. Thus, the BoT raised its key policy rate by 25bps to 1.75% at its December meeting. Nevertheless, any further tightening is likely to be gradual given slowing growth and controlled inflation (1.5% expected this year). Consensus expects one rate hike in 2019.

Meanwhile, external balances are set to deteriorate this year, driven by reduced tourism-related flows in an election year. At the same time, the slowdown in China and yuan weakness may push down tourist numbers from the mainland (28% of the total). The current account surplus is projected to fall from 7.5% of GDP in 2018 to 6.9% in 2019, still healthy both historically and relative to other EMs.

**Market Strategy**: The MSCI Thailand underperformed EM in Q4, but its trailing P/E premium over EM (21%) is close to the long-term average. Slowing growth, rising external risks and political uncertainty justify a slight reduction in exposure, but still strong fundamentals mean we stay *overweight*.

# India

*Underweight (↓)*

*Politics is returning to centre stage as elections approach and the government seeks greater control over the central bank. Meanwhile, growth is slowing more sharply than expected.*

After four years of reform attempts and policy experiments, the focus is set to return to politics in India this year. In December, the governing party, the nationalist BJP, already faced elections in five states, in some of which it scored heavy defeats to Congress. Indeed, the power base of Congress had shrunk to just three of India's 39 states and the party seemed on the verge of being eradicated. Yet, at the recent state elections, Congress won in Chhattisgarh, Madhya Pradesh and Rajasthan, all part of the BJP's traditional base. This has dented the outlook for the electoral prospects of the BJP as it approaches the national elections due in spring.

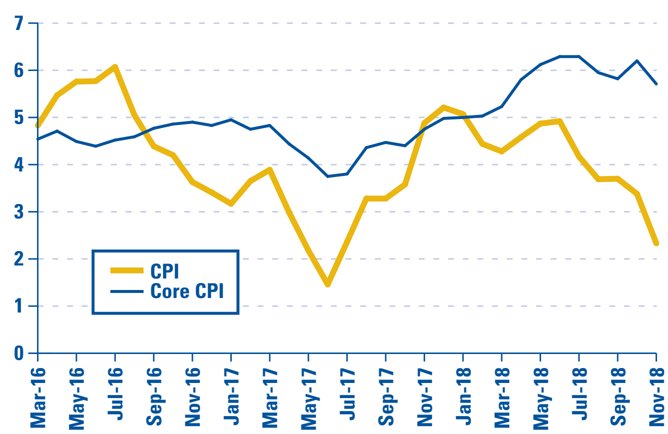
While India has fared better than many other emerging markets during several periods of turbulence last year, PM Modi's time in office has been characterized by a series of missteps. While a new bankruptcy code and the introduction of a national Goods and Services Tax (still under review and being improved upon) have been positive, other initiatives, such as the abrupt "de-monetization" in 2016 have been poorly implemented. Similarly, a recent spat with central bank Governor Patel has led to his resignation and fears that his appointed successor Shaktikanta Das will be more pliable to the government's demands, in particular insofar as regulatory policies are concerned. The government had lent on the RBI to loosen restrictions on banks saddled with bad debts and to remit more of its reserves to the central government. All told, the recent results in the state elections illustrate that the BJP has not been able to deliver the jobs it promised or a coherent policy response to the rise in inequality and the disaffection the many underprivileged groups in Indian society experience. It remains possible for either party to capture their imagination and vote.

Following an 8.2% yoy growth burst in Q2, the economy slowed more sharply than expected in Q3, to just 7.1% yoy. While less favourable base effects as well as lower agricultural and public spending played a role, the slowdown was broad-based. While the recent drop in oil prices will likely be supportive for growth, softer food prices and the tighter fiscal stance required to stay within budget during the remainder of the fiscal year will act as headwinds to growth. Industrial production abruptly slowed to 0.5% yoy in November after an 8.1% gain in October. Manufacturing PMI strengthened during the three months prior to December, but fell back slightly during the last month of the year, albeit to a still respectable 53.2. Other elements of the report were broadly encouraging as well and services PMI also held at a fairly robust 53.2. Nevertheless, the above factors together with tighter credit conditions will likely put a brake on growth, resulting in a sub-7% outcome for 2019.

After a sharp rise in mid-2017, inflation stabilized in 2018 and eventually began to decline during the latter part of the year. As food accounts for almost half of the consumer price basket, the dramatic food price deceleration over the past years has had an important effect on headline inflation. While core inflation remained resilient and even rose in 2018, an outright contraction in food prices meant that November CPI recorded a mere 2.3% yoy, the lowest level since this CPI series started in 2014. Lower oil prices, central bank tightening and the subsequent exchange rate stabilization also helped. Whereas the rupee depreciated by 17% against the USD between the start of the year and early October, it subsequently stabilized and gained 5% by year-end.

With inflation readings now below the RBI's 4% medium-term inflation target, the central bank has left its repo rate unchanged since the last hike to 6.50% in August and revised its outlook. Its December statement noted that inflation risk was tilted to the downside and the RBI shifted its baseline forecast down by 100bps. It now expects CPI inflation at 3.8-4.2% in Q2-Q3 2019. Barring any surprises in the direction of oil prices or an unexpected fiscal slippage, this opens the door for the central bank to end its tightening cycle and shift into easing mode, which would also help support the slowing economy.

## Chart 5: India Inflation, % yoy




*Source: Bloomberg, India Central Statistical Organization*

**Market Strategy**: India has weathered recent EM sell-offs well and the current weakness of the oil price is limiting its external vulnerability. However, the Modi government appears to have missed the chance to implement a more meaningful set of reforms during its time in office and is likely to do even less so if its hold onto power is weakened after the spring election. While the equity market has outperformed the index by 10% points during the past quarter, it has now become the most expensive in the EM space. With a trailing P/E of 21.7, the market is over two standard deviations above its historical premium over EM. As the economy slows and the upcoming election raises the risk for further policy interference (e.g. the spat with the central bank), we move our allocation to *underweight*.

# Latin America

## Brazil

*Underweight (↓)*

*Jair Bolsonaro decisively won Brazil's presidency, but his party enjoys only a small representation in Congress. Regardless of its plans, the administration's ability to pass economic reforms thus remains in doubt.*

Jair Bolsonaro won the presidential election as expected with an overwhelming 55% majority during the second round. However, Bolsonaro's PSL party only mustered 52 out of 513 seats in Congress (leaving the PT as the largest party with 56 seats) and four seats in the Senate. The problem of Bolsonaro's small Congressional support is compounded by his fractured electoral base composed by the military, evangelicals, conservatives and his own family as well as some traditional politicians. Having to satisfy such a multitude of potentially conflicting interests is likely to complicate efforts to build a sufficiently broad alliance to advance necessary structural reforms. Bolsonaro's economic vision remains uncertain, having voted alongside the PT during most of his Congressional career, but also having appointed Paulo Guedes, an orthodox economist, as his super-minister of the economy (combining the Finance, Planning and Industrial Policy and Trade portfolios).

It is not clear how sustainable this marriage of convenience between Guedes and Bolsonaro will be, in particular if the former fails to deliver legislative victories, given his impulsive personality, an inexperienced and under-staffed party and lack of competence in navigating Congressional door traps (Guedes did appoint an experienced team recently though). President Bolsonaro has promised a "new way of doing politics", but his attempts to bypass party leaders and negotiate directly with caucus leaders have not paid off. Similarly, his aggressive anti-corruption rhetoric could yet backfire as members of Bolsonaro's own entourage have come under investigation.

Markets have so far given the administration the benefit of the doubt, but the implementation of much-needed reforms faces an uphill struggle. These include opening the economy to trade further, simplifying the tax system, reforming labor legislation and granting the central bank formal independence. But by far the most important and watched reform will be that of the pension system, which generates a deficit of 5% of GDP and absorbs more than 50% of primary fiscal spending. Bolsonaro's ideas for pension reform are not clear but will need to tackle the following issues: 1) the retirement age, 2) the required size of pension contributions, 3) the size of pension benefits and 4) a transition rule. In light of the resistance the proposal of former President Temer encountered in Congress, the reform had been watered down through a more generous transition rule and expanded benefits, shrinking the expected savings over a decade from an initial Brl800 bn to Brl500 bn. In light of this long history and his administration's weak backing in Congress, Bolsonaro has suggested splitting up the pension system reform into smaller, more palpable bills, perhaps beginning with the retirement age. Such a strategy could ultimately prove more successful, but also speaks to the weakness of the current administration. However, vice-president Hamilton Mourao has argued for using the Temer bill, which would not require a new Congressional review, which would delay the process. Key in this context will also be the election of the new speakers in Congress and the Senate on February 1st as they effectively control the legislative agenda.

Meanwhile, the recovery remains shallow and inflation below expectations. GDP picked up to 1.3% yoy in Q3, from 0.9% yoy in Q2, but this owed mostly to temporary factors. They included the release of public funds, some payback from the May truckers' strike and an artificial boost to investments in oil platforms. As a result, Q4 will likely witness a deceleration before the recovery continues gradually. Recent industrial production readings have disappointed (1.1% yoy in October after a 2.2% yoy contraction in September), but business expectations have improved amidst the clearing of uncertainty, boding well for investment activity in 2019. Retail sales have remained weak in terms of monthly gains, but consumer confidence has continued to improve ever since reaching a trough in mid-2016 and recorded a strong bounce in the wake of the election in November. All told, this suggests that despite a weaker Q4, the recovery will continue gradually, with growth possibly reaching the 2.5% in 2019 that the Bloomberg Consensus expects.

Consumer prices have remained subdued and below expectations, easing to 4.1% yoy in November. The deceleration over the past few months was primarily due to lower gasoline prices and the disinflationary effect of Black Friday sales. Core inflation (IPCA) is running at ca 3.5% and decelerating as well. With inflation running below the central bank's target of 4.5%, it has kept the Selic rate on hold at 6.5% since March and maintained a dovish tone in its most recent monetary statement. At current rates and with BRLUSD at 3.85, the central bank expects inflation to end 2019 at 4.0% yoy, a touch below the 2019 target of 4.25%.

**Market Strategy**: Brazil's market outperformed the MSCI EM by an extraordinary 21% points during Q4. The market is pricing in complete success by the new administration in passing the necessary reforms. We think this remains as daunting as ever though and is all the more difficult given Bolsonaro's thin support in Congress and his own divisive nature. At the same time, the Brazilian market is expensive, with a trailing P/E of 17.1, equivalent to a 50% premium to the EM trailing P/E and more than double the level a year ago. We thus shift our allocation back to *underweight*.

## Mexico

*Overweight*

*AMLO's presidency is likely to shift policy priorities but won't overturn the country's basic economic model. A mild recovery and softer inflation will likely prevail.*

The election of leftist firebrand Andrés Manuel López Obrador (AMLO) in June 2018 has left many investors rattled. Fears that previous reforms and agreements could be rolled back were seemingly confirmed when AMLO subsequently decided to cancel the $13 bn project for a new airport following an impromptu "people's consultation" (with less than 1% participation as opposed to the 40% minimum required by the constitution). AMLO certainly promises to be a transformative president and has a strong representation in Congress. His Morena-PT-PES coalition commands 63% of the Lower House and 55% of the Senate (and 16 of 32 state assemblies), just short of the 2/3 majority in both houses and the 17 state assemblies required to make constitutional changes. Yet, the fiscal and financial reforms implemented by the Pena Nieto administration are unlikely to be reversed. The telecommunications and energy reforms will also likely remain intact although AMLO has declared that no new oil exploration concessions will be granted for the next three years.

Nevertheless, there are other areas that AMLO will be keen to put his stamp on. While he has railed against what he called "neo-liberalism" on the campaign trail, this is merely a shorthand for "crony capitalism". Like several of his predecessors, AMLO is keen on cutting back the power of vested interests, a monumental and thankless task in Mexico. He also aims to lift the country's growth rate from its anaemic 2.0-2.5% of the past decade to 4%, promises to fight poverty, make the economy more self-sufficient and reduce regional and social inequality. To this end, his party has formulated some 35 fundamental policies in its National Plan 2018-2024. These include a series of infrastructure projects such as the construction of oil storage facilities and refineries in the country's South and the building of the "Mayan train" to the South East. It also aims to put 2.6 mn young citizens to work through the provision of a MXN3600 monthly stipend which will allow them to either 1) continue school, 2) enrol in training or 3) take up an apprenticeship. In addition, AMLO promised to raise pensions for the elderly and increase subsidies for farmers.

But while planning to raise capital and social spending, AMLO has also promised not to raise taxes, increase the fiscal deficit or the public debt level. Eventually, one of these promises will have to give and it may be market pressures that will force the adjustment. The budget presented on December 15 suggested that any shift towards populism would indeed be carried out in a fiscally responsible way. Crucially, Finance Minister Urzua set a target for the primary surplus of 1% of GDP (consistent with a 2% overall deficit), even higher than the 0.8% of GDP that was likely achieved in 2018. Several spending promises were cut back: the scholarship program will now receive only one-third of the amount initially planned. The allocation for a universal pension for old people has also been cut back. Government spending in other departments is being cut as much as 20%. Yet, the plans for infrastructure spending remain intact. The Mayan train project is going ahead and the budget allocates some $3.5 bn to Pemex in order to fund the construction of two refineries (and to eventually cut fuel prices).

Meanwhile, activity data have remained sluggish, with industrial production in particular disappointing. Manufacturing growth has remained trapped in a 0.5-1.0% yoy range for the past three months and the PMIs have been downbeat too, having dropped to below 50 for the last two months of the year in both the manufacturing and non-manufacturing sectors. Without the strong pull of US demand, this leaves Mexico's growth vulnerable to downside surprises unless additional stimulus comes from the government's construction plans. By contrast, consumer spending has continued to accelerate through September, to the fastest pace in over a year. This has been underpinned by strong nominal wage gains, even though in real terms, wage growth has remained at +/-1% yoy.

Consumer prices continue to decelerate, having slowed to a 4.7% yoy gain in November. Yet, core inflation has remained stuck at 3.6% yoy, in excess of Banxico's 3.0% target. Together with a tighter stance by the Federal Reserve and the peso weakening, this prompted the central bank to raise its overnight rate 25bps in both November and December, to 8.25%. Indeed, the central bank has sounded more cautious in its recent statements, pointing to the risks from a shift in the new administration's policy mix which could result in slow growth paired with persistently high inflation (due to weak productivity growth and a focus on boosting consumption). Recent minutes suggested that short term factors do not require much further monetary tightening but that structural issues, such as slower potential growth, could limit the room for easing.

**Market Strategy**: Mexican equities performed poorly during the past quarter as investors had remained fearful of an AMLO victory and the change in policy thrust this could imply. As a result, the market underperformed the MSCI EM by 11.3% points. While AMLO's victory certainly shifts policy priorities, his aim is not to abolish capitalism or roll back the reforms recently implemented. Indeed, he is quite mindful of his place in history and hopes to achieve lasting success. Markets thus seem to underprice the prospects for Mexico's economy, especially given that the NAFTA/USMCA-related risk has been overcome. While Mexico's trailing P/E of 17.8 is slightly higher than that of Brazil, it is in line with its historical premium to EM. We thus maintain our *overweight* allocation.

# Emerging Europe and Africa

## Russia

*Overweight*

*Despite disciplined policies, Russia has suffered during recent market turbulence as growth is slowing while inflation picks up and requires ongoing central bank vigilance.*

Russia's economy has managed to absorb the change in the price of oil from its peak of $/brl120 in 2012 to $/brl 50 well so far, thanks to disciplined macroeconomic policies. This has also allowed it to record its best fiscal position in a decade (2.5% of GDP surplus) and a strong current account position with a 6.5% of GDP surplus. Nevertheless, exchange rate weakening, a subdued oil price and recent policies bode ill for the inflation and growth outlook.

Growth moderated in Q3, with GDP slowing to 1.5% yoy, from 1.9% yoy in Q2. Support came from a rebound in capital spending and the mining sector as OPEC+ output cuts supported oil prices. Since then, PMI readings have been robust, having risen to over 52 for the manufacturing sector and beyond 56 for the non-manufacturing sector. This could provide a boost to activity in Q4.

Consumer prices began to rise from a low of 2.3% yoy mid-year 2018 and ended the year at 4.2% yoy, that is, at the top of the central bank's 3.8-4.2% target range. Part of the rise reflected the sharp sell-off of the ruble against the US dollar (over 22% in 2018, some 7% during the last quarter) and the unmooring of inflation expectations. The central bank hiked rates twice during the past quarter, by 25bps each time, once in September and once, unexpectedly, in December, bringing the key policy to 7.75% by year-end. The CBR's statement remained hawkish, stressing various inflation risks stemming from both external and internal factors and suggesting the potential for additional moderate tightening in 2019.

A key factor for the outlook for both inflation and growth is the planned hike of the VAT rate by 2% points to 20% as of January 2019. This could not only weigh on consumer spending – the key growth driver during the recent recovery – but also boost inflation by an estimated 1.3% points. Together with the ongoing pass-through from the exchange rate (and assuming no further depreciation), inflation will likely rise further in 2019 and require vigilance by the central bank, which will likely aim to keep the real rate in the 2-3% range it regards as appropriate.

**Market Strategy**: Having outperformed the MSCI EM earlier in 2018, the Russian market fell behind the index by 1.5% points during Q4. It faces several important headwinds in 2019 and, as ever, remains at the risk of a deterioration in relations with the US (viz sanctions). However, given the unchallenging valuations of the Russian market (trailing P/E at a 58% discount to EM against a long-term average of 54%), we maintain our *overweight* in case oil prices rise substantially in 2019.

## Turkey

*Underweight*

*The 2018 political crisis is winding its way from the exchange rate through inflation to the real economy. Activity is expected to contract in 2019.*

Turkey's economy continues to live down the consequences of President Erdogan's "self-coup" in June 2018, his subsequent political appointments and his policy moves, in particular those aimed at the central bank. While in 2018 the impact was most visible in the currency and inflation readings, it is likely to be the real economy that bears the brunt in 2019. The lira had reacted first, selling off by over 45% against the US dollar between the start of 2018 and mid-August. The tide was only stemmed after a cumulative 800bps worth of rate hikes by the central bank, coupled with various administrative measures. The lira has since strengthened some 20% against the US dollar.

Rapid currency depreciation and worsening inflation expectations pushed up wholesale and consumer prices, which climbed from ca 10% yoy in Q1 to a peak of over 25% in October. Following the central bank's drastic measures, CPI eased to 20.3% yoy by year-end, but core inflation remained elevated, at 19.5% yoy (PPI dropped from 45% yoy in October to 33.6% yoy by year-end). Several competing pressures now affect the inflation outlook. On the one hand, a 25% hike in the minimum wage is boosting price pressures. On the other hand, weak domestic demand, a tax cut on consumer durables (extended for an additional three months recently), depressed energy prices and cuts in various important utility prices are containing inflationary pressures. Inflation is expected to remain elevated during the first half of the year, before easing to 15% or below by year-end, but will remain subject to exchange rate volatility. The central bank could start easing rates by mid-year from the current crippling level of 24% if it judges conditions sufficiently conducive.

Meanwhile, the crisis has depressed activity, with a sharp contraction of GDP in Q3. Due to favourable base effects, the headline rate remained at 1.6% yoy in Q3, but this is substantially weaker than 7.1% yoy and 5.3% yoy in the preceding two quarters. The collapse in business and consumer confidence, ongoing policy uncertainty and the sharp contraction in lending bode ill for the further outlook. Even though the currency and inflation have stabilised, corporates laden with foreign debt are struggling and nearly 1,000 have filed for bankruptcy in 2018. As a result, lending has collapsed following years of hefty expansion. Forecasts for 2019 thus expect the economy to remain nearly flat at best (the IMF expects 0.4% growth) or to outright contract (Moody's anticipates -2%).

**Market Strategy**: Turkey staged a recovery during the last quarter, outperforming the MSCI EM by 12% points. But the outlook remains dire as interest rates remain high in the face of political and policy uncertainty, while the economy enters a recession. We maintain our *underweight* allocation.

## Romania

*Neutral*

*Growth is set to remain healthy, but populist measures announced in December leave policy shrouded in uncertainty.*

GDP in Romania expanded by 4.3% yoy, above market expectations of 3.7% and up from 4.1% in Q2. Growth was driven by household consumption (4.4% yoy), which accounts for around two-thirds of GDP. However, investment and net exports detracted from value added. These trends are likely to continue, contributing to a slowdown in growth towards potential. This translated to a slowdown from an estimated 4.0% yoy in 2018 to a forecast 3.5% this year.

Inflation in 2019 is expected to fall back to the upper bound of the central bank's (NBR) 1.5-3.5% target range. Part of the fall from an estimated 4.7% in 2018 is due to favourable base effects, while the lagged impact of monetary tightening should dampen price pressures. The NBR raised its key policy rate by 75bps to 2.5% in 2018, with a further 50-75bps of rate hikes projected by market consensus for 2019. However, upward pressure could come via imported inflation given policy uncertainty and external financing requirements.

External shortfalls are set to remain wide. The current account deficit is projected at 4.0% of GDP this year, in line with that estimated for 2018. The slowdown in growth may suppress imports and reduce the trade deficit though, while lower oil prices (-10% yoy in leu terms) should also help.

However, the fiscal measures announced in December by an emboldened government, led by the Social Democrats (PSD), were populist in nature. This risks reducing FDI and could make financing the current account shortfall more challenging. The measures included a so-called "greed tax" on banks and gas and electricity companies, as well as a cap on gas and electricity prices for households, effective from the start of 2019. Confidence in Romania's institutions is also deteriorating due to a number of developments. These include departures from the national anti-corruption unit and questions over the Constitutional Court's independence. A ruling by the court that invalidates wiretap evidence would negate hundreds of corruption convictions, including that of PSD leader Liviu Dragnea.

**Market Strategy**: MSCI Romania's trailing P/E trades at a 46% discount to EM (1.3 standard deviations below the long-term average), with estimates suggesting that financial and energy companies are set to maintain healthy profitability. However, this is counterbalanced by the negative signals of populist policies and questions over the independence of key institutions. We keep Romania at *neutral*.

## South Africa

*Underweight*

*A weak economic backdrop and policy uncertainty are likely to hamper activity this year.*

South Africa's economy emerged from recession in Q3, with GDP rising by an annualised 2.2% qoq from a 0.4% fall in Q2. The rebound was driven by manufacturing (7.5% qoq) and agriculture (6.5%), but momentum is likely to dissipate. For full-year 2018, economic activity is forecast to have risen by 1.0% and to accelerate to 1.5% this year. However, forward-looking indicators suggest low levels of confidence. The Bureau for Economic Research (BER) Business Confidence index in Q4 fell to 34, well below the neutral level of 50. This is the lowest level since Q2 2017 when the country's sovereign debt rating was cut to non-investment grade. The BER Consumer Confidence index also fell sharply in Q3 after sharply rising in H1 2018 amid 'Ramaphoria'. The upcoming general election due to be held between May and August 2019 means that policy uncertainty is also set to weigh on H1 activity. Load-shedding by Eskom in December led to reduced electricity supply and although Minister of Public Enterprises Gordhan attempted to reverse this, it is likely to hamper economic activity.

Meanwhile, rising inflation (5.2% yoy in November, from a low of 3.8% in March) prompted the South African Reserve Bank (SARB) to raise its key policy rate by 25bps to 6.75% in November. The recent fall in the rand's value (-13.6% on a real effective basis from April to September), had driven up inflation as expected, but further rate hikes are less certain given a lacklustre outlook for growth.

On a positive note, the Medium Term Budget Statement in October was more realistic, with growth estimates in line with private sector projections. This meant that government-debt-to-GDP is now expected to peak in fiscal year 2023/2024 at 59.6% of GDP, two years later than previously estimated and compared to 52.7% in 2017/18. The budget will be announced in February, with revenue measures likely required to improve fiscal dynamics.

The current account deficit has remained wide despite recessionary conditions in H1. Although the shortfall narrowed from 4.6% of GDP in Q1 to 3.5% in Q3, the latter was still 1.4% points higher than a year earlier. The shortfall is forecast to remain wide at 3.6% of GDP in 2019, which is likely to weigh on the rand.

**Market Strategy**: South Africa's equity market carries numerous downside risks including lacklustre growth, uncertainty around upcoming elections and vulnerability to tightening global liquidity. These factors, in our view, are not sufficiently reflected in valuations. The trailing P/E is at a 29% premium to EM, which is 0.8 of a standard deviation above its five-year average. We stay *underweight*.

# KEY ECONOMIC AND FINANCIAL INDICATORS

| | Emerging Market | Macroeconomic Data: % change on year ago: Annual GDP Growth* | Industrial Production* | Consumer Price Index* | Latest 12 months: Trade Balance* | Current Account Balance* | Foreign Reserves 2018 Latest* | Foreign Reserves 2017 Year ago | Currency vs $ 2018 Latest* | Currency vs $ 2017 Year ago | Short-Term Interest Rates* | Sovereign Rating S&P* | Market Data: Performance: % S&P/EM Frontier Super Composite BMI | Stock Market Index S&P/EM Front. Super Comp. BMI US$ | Change since 12/31/17 US$ | Change since 12/31/17 Local Currency | Forecast (Bloomberg)†: 2018 P/E Forecast* | EBIT Margin 2018 Forecast* | 6 month Stock Market Index Estimate (Front. Super Comp. BMI) US$* | 3 month Currency vs $ +/-* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | % | % | % | $ Bns | $ Bns | $ Bns | $ Bns | | | % | | Dec. 31, 2018 | Dec. 31, 2018 | % | % | | % | | |
| Overweight | MEXICO | 2.5 | 1.0 | 4.7 | -15.5 | -26.5 | 165.65 | 163.72 | 19.64 | 19.47 | 8.6 | BBB+ | 2.45 | 374.09 | -14.02 | -13.48 | 14.8 | 14.8 | 470 | - |
| Overweight | THAILAND | 3.3 | 1.0 | 0.4 | 19.4 | 33.3 | 194.94 | 194.68 | 32.28 | 32.45 | 1.0 | BBB+ | 2.54 | 1170.15 | -9.78 | -9.81 | 14.3 | 12.1 | 1372 | - |
| Overweight | RUSSIA | 1.5 | 2.4 | 4.2 | 0.2 | 90.6 | 369.28 | 345.84 | 69.54 | 57.53 | 7.6 | BBB- | 3.37 | 451.46 | -4.92 | 10.74 | 5.2 | 18.0 | 514 | - |
| Overweight | SOUTH KOREA | 2.0 | 0.1 | 1.3 | 70.5 | 78.4 | 392.49 | 374.69 | 1121.15 | 1062.24 | 1.9 | AA | 14.43 | 470.23 | -19.71 | -16.33 | 7.6 | 12.5 | 549 | - |
| Overweight | TAIWAN | 2.3 | 2.1 | 0.3 | 50.4 | 75.7 | 461.38 | 450.47 | 30.79 | 29.58 | 0.6 | AA- | 11.20 | 252.64 | -10.46 | -7.53 | 12.9 | 7.4 | 295 | - |
| Neutral | ARGENTINA | -3.5 | -6.8 | 48.5 | -6.0 | -35.2 | 46.97 | 46.37 | 38.09 | 18.40 | 46.6 | B | 0.50 | 462.77 | -39.97 | 20.10 | 16.0 | 21.4 | 468 | - |
| Neutral | BAHRAIN | 1.6 | n.a. | 0.7 | n.a. | n.a. | 1.95 | 1.38 | 0.38 | 0.38 | 3.6 | B+ | 0.11 | 138.42 | 6.18 | 6.13 | n.a. | n.a. | 152 | uc |
| Neutral | CHILE | 2.8 | 0.4 | 2.8 | 6.1 | -6.6 | 37.96 | 37.96 | 696.87 | 606.28 | 2.7 | A+ | 1.04 | 481.41 | -19.13 | -8.74 | 16.7 | 14.6 | 529 | - |
| Neutral | COLOMBIA | 2.6 | 5.8 | 3.3 | -6.3 | -10.7 | 45.24 | 45.76 | 3258.54 | 2932.68 | 4.5 | BBB- | 0.44 | 5010.24 | -17.33 | -10.05 | 11.2 | 30.0 | 6323 | - |
| Neutral | CZECH REP. | 2.4 | 6.7 | 2.0 | 18.3 | 1.0 | 139.86 | 144.10 | 22.67 | 21.19 | 1.9 | AA- | 0.14 | 895.83 | -4.52 | 1.12 | 13.9 | n.a. | 1017 | + |
| Neutral | EGYPT | 5.3 | 5.3 | 15.7 | -43.3 | -14.4 | 39.72 | 31.74 | 17.92 | 17.74 | 16.8 | B | 0.18 | 1355.50 | -8.19 | -7.52 | 9.7 | n.a. | 1623 | - |
| Neutral | GREECE | 2.2 | -1.1 | 1.0 | -24.5 | -6.1 | 2.15 | 2.20 | 1.14 | 1.21 | 0.1 | B+ | 0.32 | 23.59 | -31.01 | -27.90 | 14.8 | 11.1 | 28 | - |
| Neutral | HUNGARY | 4.9 | 3.3 | 3.1 | 7.7 | 2.8 | 26.44 | 25.67 | 283.58 | 256.57 | 0.2 | BBB- | 0.28 | 552.10 | -5.82 | 2.31 | 9.7 | n.a. | 536 | - |
| Neutral | INDONESIA | 5.2 | 9.0 | 3.1 | -7.8 | -28.3 | 109.44 | 120.58 | 14450.00 | 13492.00 | 6.2 | BBB- | 2.20 | 1412.40 | -7.71 | -2.22 | 16.3 | 25.0 | 1349 | - |
| Neutral | KENYA | 6.0 | n.a. | 5.7 | -11.2 | -45.9 | 9.24 | 8.57 | 102.10 | 103.40 | 7.6 | B+ | 0.12 | 641.87 | -11.37 | -12.58 | 10.2 | 21.0 | 724 | - |
| Neutral | KUWAIT | -3.5 | n.a. | 0.1 | 57.2 | -4.9 | 34.54 | 28.82 | 0.30 | 0.30 | 2.3 | AA | 0.57 | 84.93 | 13.69 | 14.39 | 8.0 | n.a. | 88 | - |
| Neutral | MOROCCO | 3.0 | 0.2 | 1.3 | -20.7 | -4.3 | 21.97 | 22.77 | 9.60 | 9.33 | 3.1 | BBB- | 0.25 | 581.93 | -8.58 | -6.36 | 18.8 | 26.2 | 601 | - |
| Neutral | NIGERIA | 1.8 | n.a. | 11.3 | 18.7 | 6.4 | 38.58 | 32.23 | 363.50 | 361.00 | 10.2 | B | 0.18 | 169.30 | -13.73 | -12.89 | 6.5 | n.a. | 189 | - |
| Neutral | PAKISTAN | 5.4 | 0.9 | 6.2 | -37.6 | -15.2 | 9.04 | 14.63 | 138.93 | 110.70 | 6.2 | B | 0.15 | 559.37 | -30.41 | -12.47 | 8.3 | n.a. | 748 | - |
| Neutral | PERU | 2.3 | 0.7 | 2.2 | 6.8 | -3.9 | 57.79 | 61.46 | 3.37 | 3.24 | 0.3 | BBB+ | 0.39 | 2039.98 | 0.11 | 0.44 | 15.5 | n.a. | 2127 | - |
| Neutral | PHILIPPINES | 6.1 | 3.9 | 6.0 | -41.6 | -9.8 | 65.19 | 70.72 | 52.55 | 49.84 | 5.2 | BBB | 1.17 | 801.60 | -16.09 | -11.61 | 17.8 | 22.1 | 787 | - |
| Neutral | POLAND | 5.1 | 4.7 | 1.3 | -5.0 | -3.0 | 107.67 | 108.15 | 3.78 | 3.46 | 1.9 | A- | 1.15 | 338.19 | -15.10 | -8.16 | 12.3 | 15.4 | 360 | + |
| Neutral | QATAR | 2.5 | n.a. | -0.2 | 43.2 | 11.9 | 27.67 | 12.56 | 3.65 | 3.67 | 2.7 | AA- | 0.95 | 279.13 | 28.34 | 28.31 | 13.7 | n.a. | 272 | uc |
| Neutral | ROMANIA | 4.3 | 5.7 | 3.4 | -17.2 | -55.1 | 35.57 | 37.77 | 4.10 | 3.86 | 2.9 | BBB- | 0.11 | 111.59 | -1.19 | 3.49 | 6.3 | 30.8 | 133 | - |
| Neutral | SRI LANKA | 2.9 | 4.3 | 2.8 | -10.9 | n.a. | 7.75 | 6.69 | 182.95 | 153.55 | 10.8 | B | 0.06 | 221.08 | -21.36 | -6.30 | 14.0 | 10.2 | 231 | - |
| Neutral | UAE | 0.8 | n.a. | 3.6 | 80.9 | 27.5 | 93.99 | 89.64 | 3.67 | 3.67 | 2.6 | AA | 0.65 | 116.99 | -3.65 | -3.64 | 9.4 | n.a. | 127 | uc |
| Neutral | VIETNAM | 7.1 | 11.4 | 3.0 | 3.3 | 12.5 | 56.32 | 38.11 | 23200.00 | 22709.00 | 4.7 | BB- | 0.37 | 204.05 | -4.78 | -2.74 | 21.0 | 18.7 | 241 | - |
| Underweight | INDIA | 7.1 | 8.1 | 2.3 | -185.0 | -61.8 | 367.19 | 374.80 | 70.00 | 63.44 | 6.3 | BBB- | 11.74 | 1045.95 | -10.16 | -1.78 | 20.2 | 13.1 | 1055 | - |
| Underweight | BRAZIL | 1.3 | 1.1 | 4.1 | 60.2 | -14.0 | 370.64 | 372.54 | 3.86 | 3.26 | 5.9 | BB- | 7.07 | 704.36 | -1.12 | 15.38 | 13.1 | 20.2 | 618 | - |
| Underweight | CHINA | 6.5 | 5.4 | 2.2 | 350.2 | 56.8 | 3053.10 | 3109.21 | 6.86 | 6.49 | 1.1 | A+ | 25.98 | 757.07 | -18.91 | -18.82 | 11.3 | 12.6 | 872 | - |
| Underweight | SOUTH AFRICA | 1.1 | 3.0 | 5.2 | 0.8 | -53.1 | 42.92 | 42.37 | 14.45 | 12.46 | 6.8 | BB | 5.66 | 674.34 | -24.21 | -12.02 | 14.6 | 15.5 | 710 | - |
| Underweight | TURKEY | 3.1 | -5.7 | 21.6 | -61.6 | -39.4 | 70.19 | 90.74 | 5.38 | 3.77 | 22.5 | B+ | 0.72 | 261.12 | -41.96 | -18.57 | 6.7 | 13.6 | 238 | - |
| Underweight | MALAYSIA | 4.4 | 4.2 | 0.2 | 29.7 | 9.2 | 98.48 | 98.35 | 4.15 | 4.02 | 3.2 | A- | 2.38 | 372.86 | -9.98 | -8.07 | 15.3 | 21.1 | 418 | - |
| | **OUT OF INDEX** | | | | | | | | | | | | | | | | | | | |
| | SAUDI ARABIA | 1.6 | n.a. | 2.8 | 87.3 | 29.6 | 497.17 | 475.15 | 3.75 | 3.75 | 2.8 | A- | 0.00 | 127.21 | 12.43 | 12.45 | 14.6 | n.a. | 131 | uc |

*Note: All data shown are as at 31 December 2018 unless stated otherwise. UC is unchanged (currency versus US dollar). S&P sovereign rating shown is long-term foreign currency rating. UAE sovereign rating shown is for Abu Dhabi. Data for countries in the Middle East and North Africa region are the latest available, but in certain cases relate to periods more than one year ago. The 34 countries shown in the table accounted for 98.9% of the S&P/EM Frontier Super Composite BMI on 31 December 2018. An additional 22 countries accounted for the remaining 1.1% of the index on the same date. These countries, which can be accessed via City of London's Frontier Markets strategy, are: Bangladesh, Botswana, Bulgaria, Cote d'Ivoire, Croatia, Cyprus, Ecuador, Estonia, Ghana, Jamaica, Kazakhstan, Latvia, Lebanon, Lithuania, Mauritius, Namibia, Panama, Slovakia, Trinidad & Tobago, Tunisia, Ukraine and Zambia.*
*†Any forecasts are based on Bloomberg consensus forecasts, where available, and assumptions. Actual results may vary from any such statements or forecasts. Past performance is no guarantee of future results.*
**Key Criteria*

*Source: Bloomberg, City of London Investment Management*

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