WILL THE YEAR OF THE DOG BE GEM INVESTORS BEST FRIEND?

With a very strong start to the year and despite some recent "air pockets", the US and world economies remain in their longest expansions since World War II; the synchronisation of the Japan, Europe and US economies, in concert with Global Emerging Markets (GEMs), continues.

Virginie Maisonneuve
Chief Investment Officer
Eastspring Investments

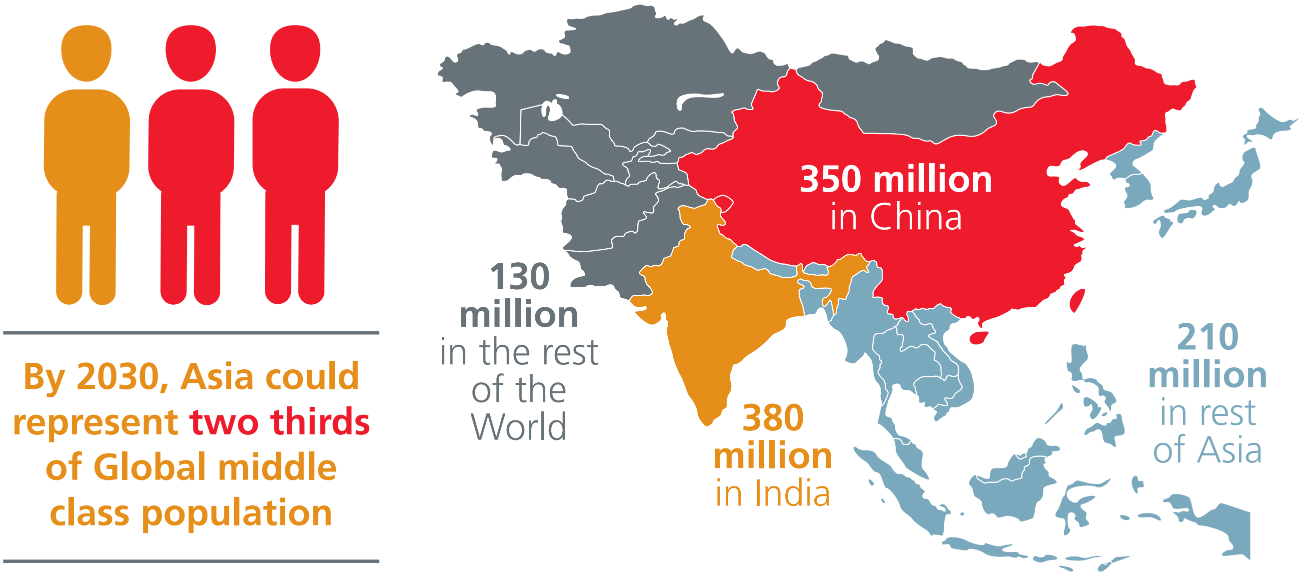
Contributing to this favourable environment are positive GDP growth, high levels of liquidity, slowly rising inflation (that remains under control) and strong corporate earnings, a combination that should support the markets throughout 2018. But, as we move closer towards true "normalisation" with rates rising, fundamentals - as opposed to liquidity - will become increasingly important. Market volatility could well return as investors attempt to identify potential tipping points given the current, unusual, extended economic cycle. Any resulting "air pockets" could well provide buying opportunities for the contrarian investor.

Evidence that this synchronised global recovery is on-going can be seen in the strong PMI and consumer confidence surveys; the latter remain strong globally with the global Ipsos Consumer Confidence Index holding steady at 50[1] in early 2018.

Mr. Powell, as he follows Janet Yellen as Chairman of the US Federal Reserve, is widely expected to follow a similar monetary policy by gradually hiking rates and reducing the Fed's balance sheet. The Fed has signalled markets to expect three rate hikes in 2018 following the 0.25% hike in December 2017. In conjunction with these rate hikes is the continued gradual reduction in the Fed's USD4.5 tn portfolio of mostly Treasuries and mortgage-backed securities, the great majority of which were acquired in three rounds of bond buying called quantitative easing.

GEMs will likely be one of the biggest beneficiaries of this continued benign environment. Emerging market long term trends also remain supportive. According to Brookings Institute, for example, the middle class market in advanced economies has matured and is projected to grow at only 0.5 to 1% per year. In contrast, the emerging economy middle class market is far more dynamic; it not only consists of around two billion individuals but could also register annual growth

Fig.1. 88% of the next billion entrants into the middle class will be in Asia



rates of 6% or more. The think tank projects that by 2030, the middle classes will account for USD64 tn in spending, 2/3rds, of which, are forecast to be in Asia.[2] Not only will they spend, they will also demand investment – housing, infrastructure, food and water.

While there will be cyclical headwinds over time, structurally the conditions for growth in GEM remain supportive for many years to come. GEM GDP is at a premium relative to developed markets; GEM industrial production continues improving; global leading indicators such as PMIs are showing positive outlook across the markets; exports are picking up amid easy financial conditions – there is a plethora of good noise out there for GEM.

The next decades will likely see Asia continue to increase its growth in marginal leadership and shine. With 58% of the world's millennial population residing in Asia, representing 25% of Asia's workforce, and 27% and 29% of China's and India's populations respectively, Asia's dynamism from a cultural and economic standpoint is likely to increase. In fact, with China and India's millennial populations today being larger at 416 million people than America's and Europe's workforce put together, Asia's consumption landscape looks set to continue to grow beyond most expectations. Some of this growth will actually materialise over a shorter-term time horizon. For example, Asian millennials are expected to spend USD340 bn on international trips by 2020.

In China, there is substantial evidence that the economy is continuing its migration towards becoming consumption and services driven with 2017 GDP growth reported to be 6.9%, even higher than target.[3] The IMF expects China's GDP growth to stand at 6.6% this year, up from the 6.5% prediction made last October, according to the latest World Economic Outlook released in January.[4] The component of personal consumption, estimated at 58.8% of China's GDP in 2017, is reshaping the economy from being export and investment driven.[5] This should help mitigate any slowdown in exports as a result of US tariffs. China is also undergoing profound transformation in the composition of its corporate sector as the "new economy companies" are growing much faster than those from the "old economy" under a judicious set of strategy targets set up by the government during the past 5 years.

China's consumption-led growth also has spin-off effects for Korea which produces many goods beloved by Mainland consumers, such as beauty products and fashion items, and consumer electronics, including phones and flash memory.[6] Investing in Korea is also a potential backdoor to investment in Vietnam's stellar growth. Korea is the largest foreign owner of Vietnamese securities and the largest FDI provider. Although technically a frontier rather than emerging market, Vietnam too is developing a vibrant middle class and producing consumer goods for export to China.

In Indonesia, real GDP growth is expected to be 5.1% in 2017, climbing to 5.3% in 2018, on a supportive global economy and stronger domestic demand. Reforms continue and gradually are starting to pay dividends as President Joko Widodo's economic reforms begin to take effect.[7] Indonesian stocks had a good year in 2017, with the Jakarta Composite Index benchmark index rising 19.99% to close at 6,355.65 points, a new all-time record high.[8] Interestingly millennials will also play an important role in the upcoming Indonesian presidential election as 30 to 40% of the voters will be represented by this demographic segment. With millennials representing 33% and 50% of the total and working Indonesian population respectively, leadership will need increasingly to connect with them.

In terms of GEMs' sectors, the growth of the middle class means a burgeoning need for financial services, loans, mortgages, and savings plans. At current valuations, we think that the financial sector is one of the most attractive ways to gain access to the growth generated by the powerful transformation taking place in GEMs.

The global markets will likely be more volatile this year, which should provide opportunities for contrarian investors particularly where strong fundamentals support the investment case – such as in the emerging markets. Asia, in particular, should fare well. With global markets participants becoming increasingly sensitive to any potential "game changer", it is important to keep a long term perspective and to use any "air pockets" to add those long term positions supported by both fundamentals and earnings. Hedging policy also will likely become more important. Rising rates in an economic cyclical upswing, need not be negative for the markets. The extended global economic cycle and the upswing in capital expenditure should benefit many emerging markets. This combined with strong domestic growth support and positive structural shifts are worth keeping in mind to support contrarian views.

Sources: [1]https://www.ipsos.com/en-hk/consumer-confidence-national-index-holds-steady he Ipsos Consumer Confidence Index is a measure of consumer attitudes in 24 countries regarding the current and future state of local economies, personal finances, savings, and confidence to make large investments fielded monthly by Ipsos Public Affairs. [2]https://www.brookings.edu/research/the-unprecedented-expansion-of-the-global-middle-class-2/ [3]https://www.cnbc.com/2018/01/17/chinese-q4-gdp-china-reports-fourth-quarter-gross-domestic-product.html [4]http://www.xinhuanet.com/english/2018-01/23/c_136918004.htm [5]https://www.reuters.com/article/us-china-economy-gdp/chinas-2017-gdp-growth-accelerates-for-first-time-in-seven-years-idUSKBN1F70OJ [6]http://fortune.com/2017/12/21/asia-investments-samsung-stock/ [7]http://www.worldbank.org/en/country/indonesia/publication/indonesia-economic-quarterly-october-2017 [8]https://www.indonesia-investments.com/finance/financial-columns/looking-back-at-2017-indonesian-stocks-having-a-good-year/item8450?

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