CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

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Asset allocatie , Nadège Dufossé , Onderwerpen

MOUNTING POLITICAL RISKS IN EMERGING MARKETS

In addition to renewed trade tensions between the US and China, political tensions, especially in Asia, have risen – China vs. Hong Kong, Japan vs. South Korea, India vs. Kashmir – triggering a rise in risk aversion for emerging assets. The results of primary-round elections last weekend in Argentina also came as a negative surprise and could put the bail-out from the IMF at risk. The political situation in Argentina has nevertheless a limited regional spillover risk. As a result, equity markets have declined by around 8% since July while emerging debt spreads have started to widen and emerging currencies have globally weakened.

Economic impact

Taking place against a background of depressed global trade and manufacturing activity, these tensions are making **downside risks more serious in Asia** in particular. While the latest economic releases were better oriented in China, with consumption and SOE investment picking up, new tariff hikes by the US, if implemented, would add to manufacturing sector woes. **Donald Trump's tweets remain unpredictable** but, for sure, uncertainty and unpredictability are weighing on investment and economic growth perspectives. At the same time, central bank accommodations are mitigating the cyclical risk.

In our core scenario, the **Chinese government will ease policies further** and probably allow a managed depreciation of the currency to reach around 6% growth in 2019-2020. Trump's incentive to strike a deal will increase as the deadline for next year's election approaches. So we continue to believe that, as long as Donald Trump does not overestimate the resilience of the US economy, **we should benefit from a "Trump" put and a "Fed" put.** This should also help Asia and emerging markets globally to find a floor.

Neutral stance on emerging equities

In our asset allocation, we have kept a neutral stance on emerging equities and will increase our exposure when we find a better risk reward. A signal that China's economy has found a trough and is starting to send turnaround signals would also make us more comfortable with a higher exposure.

Current PE 2020e is at less than 11 for the MSCI emerging markets, so, even if earnings expectations are revised down for the next 12 months, the equity risk premium is already integrating many risks. The equity market is flat year-to-date and is underperforming the US market by 15%. We have also kept our exposure to emerging debt (mainly in hard currency), which has one of the most attractive carries in our bond universe.

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