Up in the air

Weekly Digest

12 November 2018

– *Andrew Hardy, CFA*

I have been in Latin America for the past week, meeting clients across the region. Travelling abroad always provides a fantastic opportunity to get a feel for what's really going on in any given country and what's on the minds of locals. On this occasion it was a particularly interesting time to be in Mexico, where the financial markets have nosedived in the past couple of weeks. The reasons reflect the growing global trend towards populism, which makes politics an even more important element to factor into investment decisions than usual.

Despite the difficult environment for emerging markets, Mexico was holding up better with investors feeling reassured by the new trade agreement with the United States. But the mood has soured since the recently elected, populist left-wing president, López Obrador announced he would halt development of a new international airport. This was justified by the result of a referendum involving barely 1% of the population, despite construction being one third complete. Investors were quick to fear the worst for what else the president-elect may have in store when he takes control of government next month and the Mexican peso fell sharply, along with its stock market and bonds.

Locals see little logic behind the decision but are not surprised - they recall the same thing happening in 2002. Across so many emerging markets, standards of governance remain the biggest risk to foreign investors whilst also holding domestic prosperity back. Over the last ten years the Mexican peso has fallen by 50% versus the US dollar and Latin America's representation in the MSCI Emerging Markets index has fallen from 25% to 13%. Locals would have done well to diversify their investments overseas and may continue to in the future.

The theme of populism has been increasing around the world, with populist parties also winning elections in Brazil and Italy this year, whilst Donald Trump's mandate was also reaffirmed last week in the US mid-term elections. Across most countries this reflects rising levels of inequality and a loss of faith in democracy. A recent survey across Latin America, run by Latinobarómetro in Chile, found that the number of people dissatisfied with democracy has increased from 51% to 71% since 2009. It's no surprise that some of the highest levels of dissatisfaction were in Brazil and Mexico, where populist governments have been elected. Meanwhile, satisfaction was highest in Chile, Costa Rica and Uruguay, where standards of governance are generally higher and the rule of law more established.

These factors, along with a strengthening US dollar and fears around trade wars, have pummelled emerging market assets so far in 2018 and brought many down to attractive valuation levels. From these depressed levels we believe equities in emerging markets should provide strong returns over the next few years. However, we hold only modest allocations across our portfolios in recognition of the high risks involved, while we also hold many diversifying assets alongside them. Granted that developed market equities are not immune to political risk either – Italy and the UK are most worrisome today – but their well-established and entrenched institutional frameworks usually provide many safeguards that are so often lacking in emerging markets. Critically, we take an active and highly selective approach to making all such investments, to try and avoid the many spots of turbulence that lie in wait and provide investors with a smoother journey to their target outcome.

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The Marketplace

- A sluggish week for equity markets with Asia in particular seeing declines
- US mid-term elections took place
- Brent crude fell 4% to $69.90, tipping into bear market territory
- Gold fell almost 2% to $1208 per ounce

Market Focus

US

- ISM Non-manufacturing index declined to 60.3 from 61.6, this was less than forecast
- Employment gauge declined to 59.7 from 62.4. These are still solid growth figures despite cooling
- The Dow Jones index rose 2.8% to 25989.3
- US Midterm elections align with expectations with the Democrats gaining control of the House of representatives and the Republicans maintaining control of the Senate
- The NASDAQ rose 1% to 7039

UK

- Theresa May's Brexit deal which was due to be signed off today looks to be in peril as several high profile figures from both remain and leave threaten to reject it
- The CME group announced it's to move its euro denominated bond business to Amsterdam to avoid Brexit uncertainties
- UK GDP increased 0.6% in Q3 in line with forecasts. However services, the largest input - contracted during August and September
- The FTSE 100 had a flat week finishing the week up 0.2% at 7105

Europe

- German factory orders rose unexpectedly by 0.3% in October, economists were expecting a decline. A resolution of issues surrounding vehicle emissions has helped boost the auto industry
- Euro area PMI fell to 53.1 in October from 54.1 in September. This is the result of a slowdown in exports, trade tensions and political uncertainty. The euro-area economy suffered its worst growth rate in four years in Q3
- Spanish bank stocks soar after a ruling that they aren't liable for billions of euros in stamp duty that they have been passing on to customers
- European Stoxx 600 rose 0.5% to 365.7

Asia / Rest of The World

- The Shanghai Composite Index wiped out last week's 3% gain with a fall of 3.3% this week
- The Nikkei 225 Stock Average had a flat week after the previous week's large gains, closing at 22250.3
- The Yuan is nearly at its lowest level in more than a decade and has declined 9% over the last six months. The People's Bank have indicated they will open it up to international swap markets in a bid to stabilise it

Past performance is not indicative of future returns.

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

Asset Class/Region	Currency	Currency returns			
		Week ending 9 Nov. 2018	Month to date	YTD 2018	12 months
Developed Market Equities					
United States	USD	2.2%	5.4%	5.2%	9.1%
United Kingdom	GBP	0.3%	1.2%	-4.1%	-1.1%
Continental Europe	EUR	0.3%	2.8%	-3.9%	-5.1%
Japan	JPY	0.9%	5.2%	-6.1%	-5.7%
Asia Pacific (ex Japan)	USD	-1.5%	5.0%	-12.9%	-11.4%
Australia	AUD	1.4%	3.6%	1.2%	2.1%
Global	USD	1.3%	4.5%	-0.3%	2.9%
Emerging markets equities					
Emerging Europe	USD	0.2%	3.1%	-10.1%	-7.0%
Emerging Asia	USD	-2.2%	5.0%	-15.0%	-14.0%
Emerging Latin America	USD	-3.6%	0.2%	-5.0%	-3.1%
BRICs	USD	-3.1%	4.4%	-13.1%	-12.1%
MENA countries	USD	-0.6%	0.1%	6.7%	10.1%
South Africa	USD	-0.2%	8.6%	-24.6%	-11.8%
India	USD	0.8%	4.6%	-10.4%	-6.6%
Global emerging markets	USD	-2.0%	4.5%	-13.9%	-11.8%
Bonds					
US Treasuries	USD	0.2%	-0.5%	-2.4%	-2.4%
US Treasuries (inflation protected)	USD	0.3%	-0.7%	-2.7%	-2.1%
US Corporate (investment grade)	USD	0.5%	-0.3%	-3.5%	-2.7%
US High Yield	USD	0.1%	0.3%	1.2%	2.1%
UK Gilts	GBP	-0.3%	-1.1%	-1.3%	-0.3%
UK Corporate (investment grade)	GBP	-0.1%	-0.6%	-2.0%	-1.0%
Euro Government Bonds	EUR	-0.1%	-0.3%	-0.8%	-1.2%
Euro Corporate (investment grade)	EUR	0.2%	0.1%	-0.7%	-1.1%
Euro High Yield	EUR	0.1%	0.5%	-1.0%	-1.3%
Japanese Government	JPY	0.0%	-0.2%	-0.4%	-0.3%
Australian Government	AUD	-0.4%	-1.1%	2.1%	1.9%
Global Government Bonds	USD	-0.1%	-0.5%	-3.6%	-2.3%
Global Bonds	USD	0.0%	-0.5%	-3.6%	-2.2%
Global Convertible Bonds	USD	-0.1%	1.8%	-2.7%	-2.9%
Emerging Market Bonds	USD	-0.1%	0.5%	-6.3%	-4.7%

Source: Bloomberg. Past performance is not indicative of future returns

Asset Class/Region	Currency	Currency returns			
		Week ending 9 Nov. 2018	Month to date	YTD 2018	12 months
Property					
US Property Securities	USD	3.6%	2.5%	1.1%	0.2%
Australian Property Securities	AUD	3.2%	0.8%	-0.8%	-0.4%
Asia Property Securities	USD	-0.6%	1.7%	-9.7%	-8.7%
Global Property Securities	USD	2.0%	2.6%	-3.7%	-1.6%
Currencies					
Euro	USD	-0.4%	-0.5%	-5.7%	-2.6%
UK Pound Sterling	USD	0.1%	1.3%	-4.1%	-1.3%
Japanese Yen	USD	-0.5%	-1.2%	-1.1%	-0.5%
Australian Dollar	USD	0.5%	2.3%	-7.5%	-5.8%
South African Rand	USD	-0.1%	1.5%	-13.7%	-0.6%
Swiss Franc	USD	-0.2%	-0.4%	-3.2%	-1.2%
Chinese Yuan	USD	-1.0%	0.1%	-6.4%	-4.6%
Commodities & Alternatives					
Commodities	USD	-1.6%	-2.4%	-0.3%	1.3%
Agricultural Commodities	USD	-1.4%	-0.1%	-3.8%	-4.9%
Oil	USD	-3.6%	-9.3%	4.9%	9.8%
Gold	USD	-1.9%	-1.5%	-7.5%	-6.1%
Hedge funds	USD	0.1%	1.2%	-3.9%	-2.8%

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Important notes