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Bullish trend in commodities offers another reason to love EM

◆ **Commodities are among the best-performing asset classes so far this year, and the Bloomberg Commodity index is up 8.8% year-to-date.**

◆ **In tandem with that, the MSCI EM Currency index is up 0.75% so far this year, and it has just broken through a long-term resistance level.**

◆ **Many key EM central banks are likely to tighten monetary policy this year as inflation has accelerated in many countries, lending further support to their currencies.**

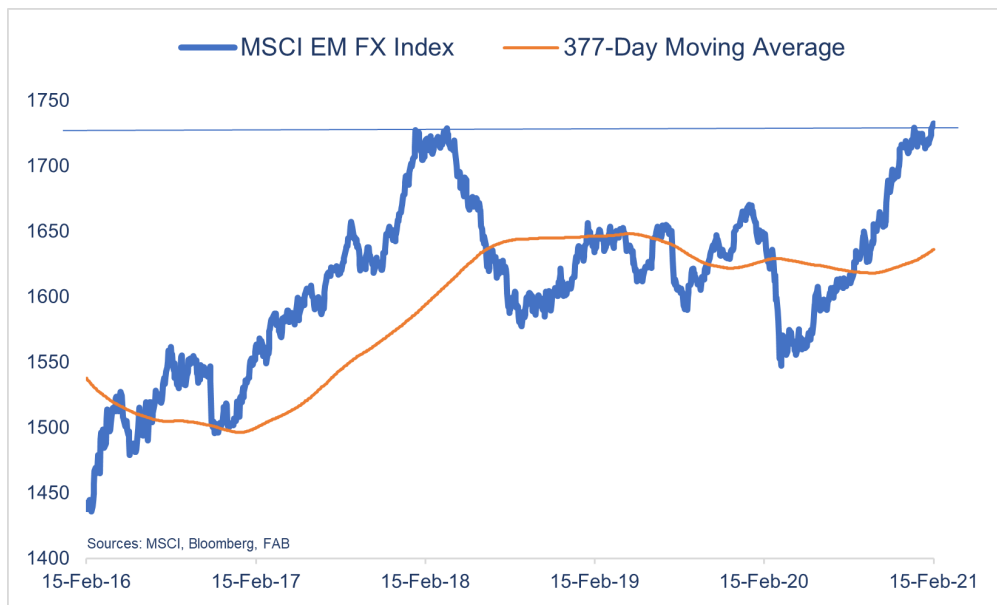
◆ **Unlike some advanced economies, most EM stock markets tend to move together with their currencies.**

◆ **The FAB AAC is overweight in equities, IG and EM bonds, and gold, and is underweight alternatives.**

Numerous banks are starting to wake up to what may be the start of a major bull cycle in commodities, and many financial media outlets are echoing their thoughts. This report indicated in the beginning of the first half of last year that commodities seemed to have turned a corner.

The forecast then was based on the potential for infrastructure investment to jumpstart the advanced economies, along with unprecedented monetary and fiscal stimulus across the world. While the infrastructure spending remains mostly a promise for now, other banks are also starting to price it in.

And if anyone is bullish on commodities, they need to have the same position on emerging market assets.



A regression of monthly returns for the Bloomberg Commodity index and the MSCI EM Currency index going back 25 years confirms that. About 27% of the moves in the MSCI EM Currency index are the results of commodity price moves, according to the study.

Indeed, just as the Bloomberg Commodity index is trading at its highest level since October, 2018, the MSCI EM Currency index has broken above the 1,730 level, a long-term resistance that had sent the index back down every time it was tested.

This is particularly bullish for EM assets, which tend to exhibit a high correlation with their home currencies.

Unlike what happens in some advanced stock markets, such as Japan and the UK, EM stocks tend to move in the same direction of their currencies. This makes sense as the appreciating currencies attract more foreign investors, which then push stock prices higher.

The MSCI EM Currency index has broken through a long-term resistance level

Similarly, the stronger currency makes it easier for companies in developing nations to get the dollars they need to pay their foreign debts, which translates into higher prices for bonds as well.

Because of this, one of the risks faced by EM investors is the direction of the dollar, which often moves with the whims of the Federal Reserve. The Fed, however, seems like it will stay put for a long time as it waits for employment to recover.

Meanwhile, many EM central banks (Brazil, Russia and South Africa to name a few) are likely to start tightening policy as inflation has accelerated. That further supports their currencies, and, by proxy, could give yet another boost to other asset classes as well.

Investment Strategy Update

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