Investment Strategy Update

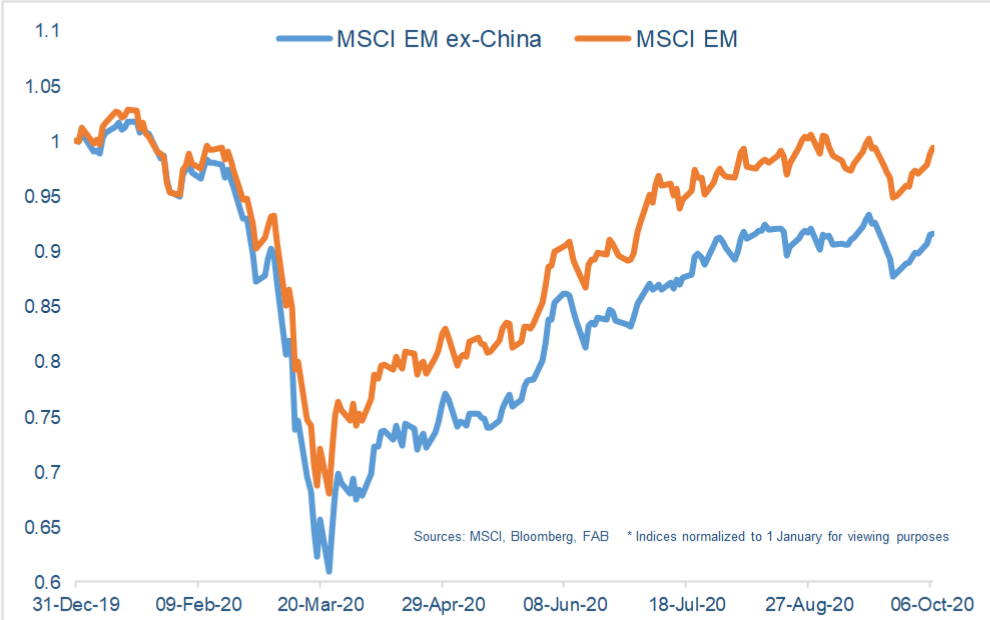
For inquiries related to this article, please contact:

Alain.Marckus@bankfab.com
Christofer.Langner@bankfab.com

8 October, 2020

A political shift and the hunt for yield could support EM assets

- **If Democrats win the elections in the US they are likely to reverse some of the nationalist stance in the US.**
- **A pro-trade stance could support developing nation exports and their economic growth.**
- **Many countries, however, still face currency headwinds as central banks have engaged in quantitative easing and fiscal spending has increased.**
- **China is outperforming the other emerging markets as investors seem to be hoping for a softer approach from a potential Democratic government.**
- **The FAB AAC favour dollar-denominated emerging market bonds.**



The past four years have been rocky for emerging markets, but they have not been bad either. Since 31 December 2016, the MSCI Emerging Markets stock index is up 28.5% while the MSCI EM Currency index has gained 8.88%.

But it has not been a straight line up. Between 26 January and 31 December of 2018, the MSCI EM stock index fell more than 24%. It has gained 14.5% back, but the index remains 12.6% below its recent high, achieved in early 2018. The pattern is similar for the currency index, which is almost 5% below its 2018 high.

Two potential reasons stand out as the cause for the significant drop in EM asset values seen in 2018 and their subsequent recovery. One is the trade war. As President Donald Trump attacked the US's trade deficit with China, EM assets dropped like dominoes. The other is interest rates.

The 2018 bear market in EM assets coincided with a round of rate hikes by the Federal Reserve. That is in line with previous rate-hike cycles, which hit developing nations particularly hard as the US dollar strengthened.

Assuming these two aspects were the key drivers of weakness in EM, developing nation markets could be about to see another period of gains. The Fed has indicated very clearly that rates are likely to remain low at least until 2023, which should remove that hurdle.

The other hurdle, however, may be more complex. If President Trump wins another term, he is likely to turn up the heat on China, which would bring back concerns about trade and nationalism. A Democratic win does not preclude those stances, but the track record of the party suggests a more friendly and globalist approach to the rising power in the East. Markets seem to be banking the latter could happen.

EM assets have started to recover and Chinese stocks have been outperforming

Chinese assets have outperformed the broader EM this year as the largest developing economy was the first to fully reopen from the lockdowns.

Asset performance of other developing nations was partly hampered by currency depreciation, though. As central banks from Brazil to Indonesia resorted to quantitative easing to fund ballooning deficits, the currencies of these countries suffered. That has impacted the dollar-denominated returns of their equity markets and local government bonds.

If that weakness cycle slows, and the US takes a softer stance toward global trade, investors could start seeking EM assets again. It may be early days, though.

Investment Strategy Update

بنك أبوظبي الأول

FAB

First Abu Dhabi Bank