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NEDGROUP INVESTMENTS GLOBAL EMERGING MARKETS EQUITY FUND

Quarter Two, 2019

For the period ended 30 June 2019

NEDGROUP INVESTMENTS GLOBAL EMERGING MARKETS EQUITY FUND

Commentary produced in conjunction with Sub-Investment Manager, NS Partners Ltd

Executive Summary

Global emerging markets made further modest gains over the period following the strong first quarter. The trade war and geopolitical tensions concerned investors, but stocks were supported by strong global bond markets and expectations that the Federal Reserve will cut interest rates a number of times later this year. The MSCI Emerging Markets index rose 0.33% in local currency terms and 0.74% in US dollars. Financials were the best performing sector gaining 4.38%, while healthcare was the worst, falling 6.64%.

Global economic data continued to disappoint in Q2 as anticipated by our forecasting approach which suggests that the downswing is entering its final stage. Early indications are that 2020 will be a recovery year for the global economy, although this requires confirmation from a further rise in monetary growth. A bottoming of economic momentum may be associated with an increase in market volatility and a reversal of several recent trends. Recent asset class performance has in most respects displayed the defensive pattern expected with Treasury yields falling, credit spreads widening, US and quality stocks outperforming, emerging market equities underperforming, commodity prices weakening and the US dollar strengthening.

A notable discrepancy in the recent returns pattern is the resilience of equities in aggregate which may partly reflect an unusual contraction in the global share float, with buy-backs and cash take-overs boosted by US tax reform and low corporate borrowing costs. Currently, we prefer liquidity-sensitive markets likely to benefit from monetary policy easing and remain cautious on cyclical / commodity price exposure. Domestic monetary trends, meanwhile, suggest overweighting India, South East Asian markets, Poland and Greece, while underweighting Brazil, Mexico and Russia.

In China, the economy has yet to respond convincingly to easier monetary policy and there appears to be a reversion to pump priming which may be a sign of the underlying weakness in activity not evident in the official statistics for GDP. The trade war with the US is impacting manufacturers and government policies are being directed towards alleviating employment pressure in the export sector. There is some evidence of a credit crunch among smaller banks with funding costs rising and high inter-bank borrowing rates. The authorities have taken over a small bank in Mongolia and will pursue a ‘whatever it takes’ approach to shore up the banking system and prevent a credit crisis. Despite these pressures the government will not want to lose face in the trade negotiations with the US and can play a long waiting game in the hope of a change of president in 2020.

Elsewhere in Asia investors welcomed the re-election of Narendra Modi as prime minister of India but he faces an economy that has slowed to its lowest growth rate for five years not helped by the crisis in the non-bank financial sector. The new finance minister Nirmala Sitharaman has tabled a budget cutting the budget deficit while attempting to stimulate growth through corporate tax cuts. The government is planning to sell sovereign debt abroad, privatise more state assets and relax restrictions on foreign investment in certain sectors. In Korea, attention on the headline grabbing meeting between Donald Trump and North Korean dictator Kim Jong Un in the demilitarised zone has been overshadowed by the growing trade war between South Korea and Japan over compensation for wartime forced labour. Japan is imposing restrictions on exports of chemicals vital for chip making in response to Seoul’s decision to let its courts seize Japanese companies’ assets.

In Latin America Brazil’s pension reform bill has made slow progress finally passing a first vote in Congress at the time of writing but requiring a second before moving to the Senate. Reform of the generous state pension provision system which amounts to almost 13% of GDP is seen as key to restoring confidence in the Brazilian economy and a litmus test of new President Bolsonaro’s ability to pass additional economic reforms. This comes at a time when the Brazilian economy shrank in the first quarter by 0.2%, the first contraction since 2016. In Mexico markets were shaken by the resignation of respected Finance Minister Carlos Urzua after just seven months in office. This is seen as a signal that the new leftist President Obrador wants to push ahead with his socialist agenda despite a trade war threatened by President Trump if Mexico fails to cut migration to the US. In South Africa President Ramaphosa’s government is attempting to prop up the stricken utility Eskom which is holding back the economy through blackouts restricting activity at factories and mines. The power shortages dragged economic output 3.2% lower in the first quarter on an annualized basis.

Transactions over the period have reduced the underweight in Asia through purchases in India and Taiwan. Russia and the Czech Republic have had ratings downgrades and been reduced. In terms of sectors we have reduced materials and communications in favour of consumer discretionary, financials and IT. The portfolio declined 0.38% versus a 1.8% fall for the benchmark since April 29th. Stock selection was the main positive over the period notably in China and Korea. Chinese sportswear group Li Ning had another strong quarter gaining 51% after the company upgraded H1 profit expectations.

Performance Attribution and Comment

Since Inception to June 28, 2019	Allocation (%)	Stock Selection (%)	Net Impact (%)
Total	**0.11**	**1.18**	**1.30**
Emerging Market Asia	-0.04	1.21	**1.17**
China	0.12	1.18	**1.31**
Korea, Republic of	0.07	0.35	**0.42**
Taiwan	-0.03	-0.28	**-0.32**
India	-0.11	-0.03	**-0.14**
Malaysia	-0.02	-0.10	**-0.12**
Thailand	0.04	0.09	**0.13**
Emerging Markets Europe, Middle East and Africa	0.32	-0.31	**0.01**
South Africa	0.01	-0.02	**-0.01**
Russian Federation	0.00	-0.32	**-0.32**
Emerging Market Latin America	-0.21	0.29	**0.07**
Brazil	-0.18	0.16	**-0.02**
Mexico	0.01	0.03	**0.04**
Frontier Markets	0.00	0.00	**0.00**
Cash	0.04	0.00	**0.04**

The MSCI Emerging Markets index posted a declined 1.8% in US dollars since April 29th. The fund outperformed declining 0.38% with much of the relative gain due to stock picks although both sector and country selection were also positive.

Over the second quarter the best performing sectors were financials (+4.38%) and consumer staples (+3.43%) and overweights here were positive. The weakest sectors were healthcare (-6.64%) and communication services (-2.36%), both of which were underweights. Consumer discretionary, our largest sector overweight, was disappointing with a return of -1.12%; however, security selection within the group more than offset the negative impact.

In Asia, security selection was strong in China and Korea, only partly offset by negative relative performance in Taiwan, the Philippines and India. In China the portfolio benefitted from continued strong performance in consumer discretionary, communication services and financials. In consumer discretionary Li Ning had a second consecutive outstanding quarter with the shares up 35% following better than anticipated results. The company issued raised guidance for its forthcoming H1 results as required when sales growth exceeds 20%. Sales are expected to increase by approximately 30% YoY and net profit by 164%, significantly ahead of the anticipated recovery from a poor 2018. The drivers have yet to be detailed by the company, but its margins continue to improve as advertising costs targeted to social media are growing less than sales. The surge is enhanced by a one-off revaluation gain, but the underlying metrics are the principal driver. Li Ning is a sportswear company and the largest domestic brand with consumer mindshare on a par with Adidas (viewed as a premium brand). Mr. Li Ning, an Olympic champion gymnast, founded the eponymous company and had great success before retiring.

Mr. Li returned to an executive role and the continued improvement in results is testament to his management capability. Net operating margin of around 7.2%, even after the latest improvement, is still well below international peers and the company's own historic level of 12%.

In consumer staples momentum at Wuliangye Yibin was sustained from Q1. The (Baijiu) spirit distiller gained 23.6% over the quarter as management continued to deliver on the benefits of its premiumisation strategy. Wuliangye is the no.2 liquor producer and there remains significant room for higher prices as the gap to market leader Moutai remains large. Management had indicated that the recovery in 2018 results will continue in 2019 and the Q1 results in April confirmed this. Sales increased 27% YoY and gross margin was up 2.6% while operating margin gained 2.4% to 50.1% as costs were steady over the period. Analysts remain upbeat and estimates continue to see upgrades for both Wuliangye and Li Ning.

In Chinese financials our overweight in insurance worked well as both Ping An and AIA delivered gains of 8.8% and 9.7% respectively with sentiment boosted by a change in Ministry of Finance rules on the tax deductibility of commissions on life policies underpinning an already strong segment.

Korean security selection was boosted by the strong relative performance of Samsung Electronics (+4.04%) over other Korean IT names including SK Hynix. Samsung is a leading player in semiconductors as well as mobile phones and consumer electronics. Q1 results were weak as expected even including one-off gains in its display division but more encouraging were signs that the company is regaining market share in mobile phones. As a vertically integrated business this feeds through to higher margin components divisions.

In India HDFC gained 11.8% as Prime Minister Modi and his BJP party had an unexpectedly convincing victory in the national election. Continuity in economic policies is expected to support the long-term prospects for India's mortgage market in which HDFC is the leading player. Q4 results were strong (Indian companies have a March year-end) with profit up 27% YoY, ahead of expectations. Elsewhere in India our middle-class hotel operator Lemon Tree had a disappointing Q2 declining 16.9%. Q4 results were softer than the market and we had anticipated but were not disastrous. Room occupancy at 77.6% was up marginally on last year but not as much as in the preceding quarters. The delay by two months of the opening of its flagship Mumbai property coupled with weaker business sentiment in the run-up to elections were behind the poor sentiment. These short-term headwinds will fade as the election result underpins confidence in the growth potential for India.

In Russia, similar to India, strong performance came in financials where Sberbank rose 23.6% and the overweight was positive for relative performance. Despite this, overall security selection in Russia was negative as our positioning in the energy sector proved troublesome. We are zero weighted in Gazprom, the state-controlled energy major, due to poor returns on capital and corporate governance concerns. However, the company's shares were strong in Q2 as a higher dividend pay-out policy was announced and there was speculation regarding a change in senior management. By contrast our holding of private sector Lukoil declined 5.8% as the company's weighting in the MSCI Russia index was lowered in May. Lukoil has been distributing its strong free cash flow via dividend and share buy backs. The buy back and cancellation of shares has led MSCI to reduce the index weight of Lukoil as the free float has declined. We feel that the policy is sensible and in the interest of shareholders but the unexpected near-term contrast between news flows for the two companies has been unhelpful this quarter.

In Latin America security selection was positive in most markets. In Brazil, Lojas Renner in consumer discretionary and Odontoprev in health care both performed well. Lojas Renner is defying a weak consumer environment to take market share in apparel retailing. We believe that the company's focus on customer and supply chain efficiency is a major differentiator and the group delivered a strong beat in its Q1 results with the stock up 21.2%. It is impressive that the business delivered same store sales growth of 12.7% while unemployment remains stubbornly high in Brazil. This underlines the competitiveness of its offering to consumers. Lojas is investing cautiously in e-commerce with a click and collect focus as last mile delivery remains a tough proposition in Brazil. Consolidated EBITDA rose 30.7% and EPS was up 49.5%. Odontoprev in health care is a similarly well run dental service provider with a market leading share of big corporate, SME and individual plans in a country that has more dentists per capita than even the US. Odontoprev distributes its plans through its exclusive partnerships with two of the country's largest banks - Banco Itau and Banco do Brasil. The company provides dental plans to customers through a network of independent approved dentists and the work and supply of materials is controlled centrally with treatment approved and reviewed by the company ensuring high quality and cost control for clients. The dental loss ratio (cost of service provision) improved in Q1 and the increase in exposure to the individual market with higher initial costs but improved overall margins is beginning to bear fruit. Odontoprev gained 14.3% in Q2.

Recent Activity

Top 10 Purchases

Country	Security	Sector	%
India	Housing Development Finance	Financials	3.68%
India	Lemon Tree Hotels LTD	Consumer Discretionary	2.39%
India	Varun Beverages Ltd	Consumer Staples	2.20%
India	Oil & Natural Gas Corp Ltd	Energy	1.86%
Taiwan	Mediatek Inc	Information Technology	1.25%
Korea, Republic of	Lg Chem Ltd	Materials	1.24%
China	China Merchants Bank-H	Financials	1.23%
Taiwan	Tci Co Ltd	Consumer Staples	1.20%
Greece	Mytilineos Holdings S.A.	Industrials	1.02%
Peru	Credicorp Ltd	Financials	1.00%

Top 10 Sales

Country	Security	Sector	%
China	Bank Of China Ltd-H	Financials	1.89%
China	China Life Insurance Co. - HK	Financials	1.29%
Taiwan	Taiwan Semiconductor Manufac	Information Technology	1.05%
Korea, Republic of	Kb Financial Group Inc	Financials	1.02%
China	Tencent Holdings Ltd	Communication Services	0.91%
Russian Federation	Tcs Group Holding -Reg S	Financials	0.82%
Brazil	Banco Bradesco On	Financials	0.75%
Philippines	Jollibee Foods Corporation	Consumer Discretionary	0.62%
Indonesia	Hanjaya Mandala Sampoerna Tbk	Consumer Staples	0.61%
Malaysia	Heineken Malaysia Bhd	Consumer Staples	0.60%

Transactions over the quarter have reduced the underweight in Asia funded from cash and a reduction in emerging Europe. We added to India ahead of the election result with the purchase of conglomerate, refinery and petrochemical giant Reliance Industries where the demerger of telecom tower and fibre assets is driving a significant deleveraging. The company continues to shift away from capital intensive, industrial operations to more consumer orientated businesses creating special purpose vehicles to foster an asset light model. We have also added to Oil & Natural Gas Company (ONG) as this company and Reliance should benefit from a second Modi government continuing to reduce subsidies in the energy sector. The new government could take action over the next five years to eliminate kerosene subsidies and this plus some exciting offshore fields and development blocks in Mozambique should drive a re-rating of the stock. In financials we have introduced HDFC Bank which provides corporate banking and custody services and has capital market operations. Management are confident that they can grow the business faster than the industry through a strong distribution franchise and market share gains.

Margins are robust thanks to good pricing power and improving deposit taking with the number of branches expanding by over 600 a year. We have also added to Housing Development Finance which provides long-term housing loans to low and middle-income buyers where our buy thesis is developing as hoped with the company likely to achieve 16% annual loan growth over the next two years while return on equity will rise as it expands its balance sheet. In technology we have bought software company HCL Technologies which provides a range of consulting services across various industries. Large deal wins have been accelerating and the pipeline appears healthy with engineering services growth picking up. This is another company that should benefit from the business confidence engendered by a second Modi-led government.

Elsewhere in Asia we have reduced the underweight in Taiwan through purchases of staple companies TCI Co and Uni-President Enterprises. The former is a health food specialist which is benefiting from the global trend towards better diet helped by aging populations and rising incomes in emerging markets. TCI designs and manufactures functional drinks, health-food supplements and beauty products. Its sales are growing in China where demand for healthy food is booming. Uni-President Enterprises produces manufactured food and is driving a margin expansion in its Chinese business through innovation, product mix improvement, supply chain efficiencies and favourable raw material prices. The Taiwan operations are also growing steadily, and the recent acquisition of Woonjing Food in Korea will help distribution and fill some product gaps. We have also bought fabless semiconductor group Mediatek which provides chips for a range of consumer electronics. The company has a strong competitive position in 5G where with deployment ramping up across Asia. Margins are improving as the proportion of sales of higher-end products rises.

In China we have re-introduced car maker Geely Automobile which has launched its electronic vehicle (EV) brand Geometry in Singapore. Car sales have been weak in China but the success of its EV strategy could lead to a re-rating of the shares which have more than halved since their peak in November 2017. We have also bought China Merchants Bank which has reported strong net interest margins driven by high retail loan growth and successful funding cost control. We expect management to drive more product innovation to help the retail business and raise the dividend payout ratio given the bank’s high long-term ROE of over 16%. We have also topped up online retailer Alibaba and utility operator Guangdong.

Other new positions include Tisco Financial Group in Thailand, Samsung Life Insurance in Korea and Credicorp in Peru. Tisco is a high return on equity lender with falling risk weighted assets allowing increased dividends for shareholders. Samsung Life shares have been weak trading at a historic low valuation, but the latest results beat consensus and new business growth is encouraging. Credicorp is a financial conglomerate which is an attractive way of playing the strength in money growth in Peru which has driven our rating upgrade.

On the sell side we have reduced Russia with the sales of gas company Novatek and online retail bank TCS Group after downgrading the rating on weaker money numbers. We also downgraded the Czech Republic which led to the sale of telecom group 02 Czech Republic which is also facing greater regulatory and competitive risks. The underweight in materials has increased with the sale of steel maker Posco in Korea and Grupo Mexico. Commodity prices are under pressure from the global economic slowdown and trade disputes. In China we have sold travel IT service group TravelSky and reduced Tencent and Wynn Macau. We have also taken some profits on liquors maker Wulliangye Yibin and exited Bank of China where net interest margins are under pressure from the slower economy. We have trimmed one of our favourite long–term stories Taiwan Semiconductor to reduce risk as demand has slowed and sold another much-loved fast food company Jollibee Foods in the Philippines where the top line is showing signs of slowing.

Portfolio Strategy

Global emerging markets made further modest gains over the period following the strong first quarter. The trade war and geopolitical tensions concerned investors, but stocks were supported by strong global bond markets and expectations that the Federal Reserve will cut interest rates a number of times later this year. The MSCI Emerging Markets index rose 0.33% in local currency terms and 0.74% in US dollars. Financials was the best performing sector gaining 4.38%, while health care was the worst, falling 6.64%.

Earnings estimates were revised down in Q2 by 3.2% but 12-month forward consensus profit expectations are at a respectable 9.7% in aggregate. This may prove optimistic given the current weaker global economic data and late position in the developed market cycle. We remain a small underweight in energy - the oil price fell 3% as measured by Brent as production disruption in Libya and Venezuela and the end of sanction waivers for Iranian oil were offset by weak global demand, US shale production and the ongoing shift to alternative sources of energy. OPEC agreed a nine-month extension of price-supporting production cuts, but the cartel continues to lose market share and faces a long wait for shale production to fall especially as new pipelines connecting fields to export hubs open up. President Trump may also bring pressure to bear on Saudi Arabia to keep prices low ahead of the presidential election in 2020. Renewables growth is hitting gas prices, which is also bad news for the oil majors' earnings revisions.

The portfolio is also underweight, although iron ore prices have risen dramatically over the quarter leading to earnings upgrades for the likes of Vale in Brazil. Supply is tight and fiscal stimulus in China and stable steel demand have squeezed prices in what is a much more concentrated production structure than for other commodities. Demand is resilient due to state backed infrastructure pump priming in China that is unsustainable in our opinion. This strength is in marked contrast to other metal prices where weakness has reflected softer global economic demand. We favour Conch Cement in China which has pricing power and decent sales volume. We also like Lg Chemical in Korea where robust growth in its battery segment will drive the longer-term value of the business.

We are also underweight industrials with Greek conglomerate Mytilineos the only holding in the sector with the company benefiting from a high alumina price and improvement in its power and gas business. Chinese air traffic growth has been robust and airline profits have been generally good although currency and fuel price developments remain a headwind. The demand for aircraft remains positive although the grounding of the 737MAX has affected Boeing and its suppliers. While auto and semi end markets have been under pressure process industries have provided some support.

We favour consumer discretionary and staples with the focus on companies that will benefit from rising incomes across the emerging markets universe. In consumer discretionary, the picture for Chinese auto demand is blurred with weak numbers in wholesale but signs of improvement at retail showrooms particularly for premium vehicles. In consumer staples, Chinese consumer sentiment has remained remarkably high despite the trade and geopolitical tensions. Food companies need to be more granular and flexible with disciplined approaches to innovation and e-commerce channels. In food retail the focus also remains on the shift to online and delivery platforms which is causing structural changes to global food consumption with less home cooking in favour of restaurant food. We like companies such as Lemon Tree Hotels in India which is shifting to an asset light model with growing brand awareness. Another large active position in the consumer area is China Mengniu Dairy which is benefiting from solid secular dairy trends and a premiumisation story.

The portfolio is underweight health care with Brazilian dental specialist Odontoprev the only position. The company is seeing the best top line growth for many years and margins should stabilise. Financials is a favoured sector and the portfolio has banks and insurance stocks across regions as a way to capture growing wealth across markets. We are close to index weight in IT where the cycle in memory has been more severe than some expected. The smartphone market has been weak, while there has been a PC-CPU shortage and a data centre build-up of inventory. However, the digital revolution is changing business models at a rapid rate and enabling a boom in accessibility and productivity. Why are emerging markets at the forefront of these trends? Because we are witnessing China and India emulate the US in the late C19th, early C20th. Just as Germany and the US caught up with and eventually overtook the UK, the first industrial nation, the new emerging markets won't blindly adopt the same old technology – they will go for the new technology and methods. The portfolio is underweight communications, utilities and real estate which are typically capital-intensive industries which do not screen well on our economic value-added assessments.

Asset Allocation

Region	Portfolio (%)	Benchmark* (%)	Deviation (%)
Emerging Markets Asia	69.88	72.11	-2.23
China	29.25	31.55	-2.30
Korea, Republic of	8.64	12.37	-3.73
Taiwan	11.09	10.83	0.26
India	13.44	8.97	4.47
Emerging Markets Europe, Middle East & Africa	11.10	15.60	-4.49
South Africa	3.91	5.94	-2.03
Russian Federation	3.53	4.04	-0.50
Emerging Markets Latin America	10.26	12.29	-2.03
Brazil	6.01	7.65	-1.63
Mexico	1.99	2.54	-0.55
Frontier Markets	0.99	0.00	0.99
Developed Markets	4.02	0.00	4.02
Cash	3.74	0.00	3.74

Sector	Portfolio (%)	Benchmark* (%)	Deviation (%)
Energy	6.74	7.94	-1.20
Materials	2.78	7.59	-4.80
Industrials	0.99	5.33	-4.35
Consumer Discretionary	21.09	13.45	7.64
Consumer Staples	10.33	6.59	3.75
Health Care	0.52	2.63	-2.11
Financials	30.95	25.24	5.71
IT	12.54	13.86	-1.32
Communication Services	6.48	11.69	-5.21
Utilities	2.06	2.69	-0.63
Real Estate	1.77	3.00	-1.23
Cash	3.74	0.00	3.74

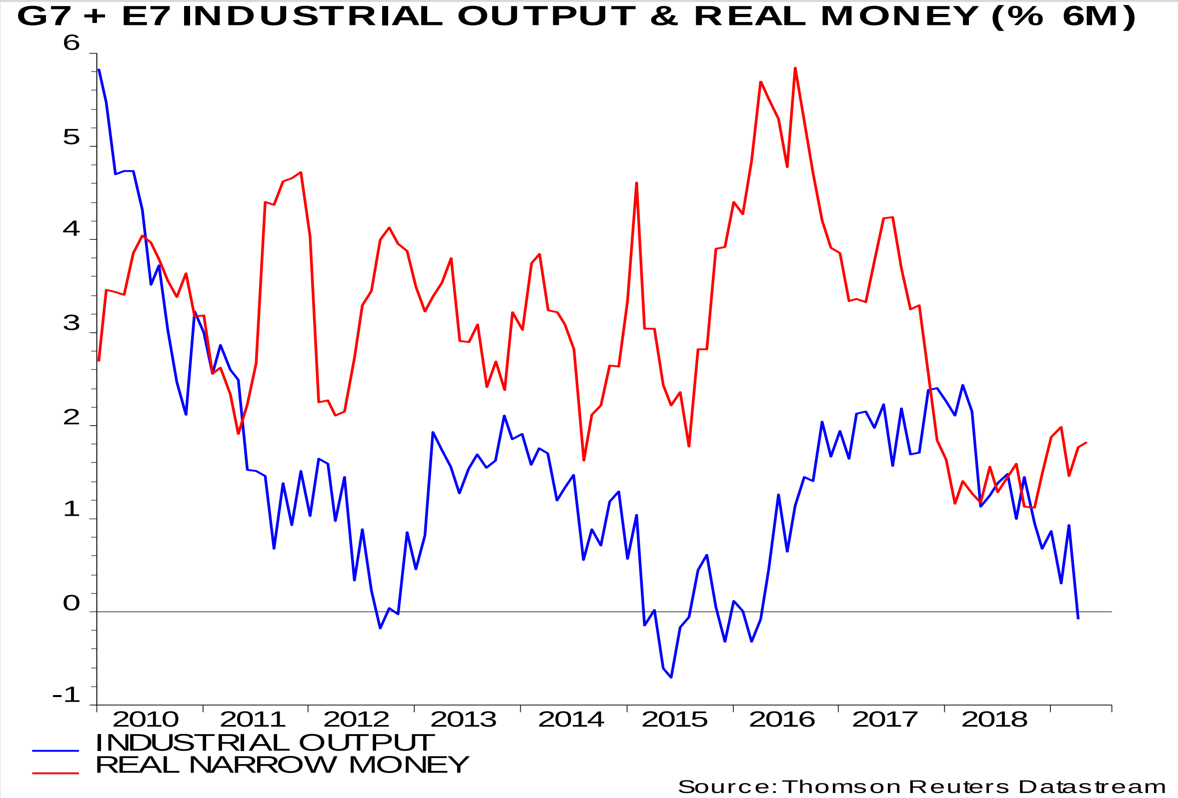
**Benchmark: MSCI Emerging Markets*

Review and Outlook of Liquidity Trends

EM equities have underperformed developed markets since the global economic slowdown began in early 2018, lagging again last quarter. Our analysis suggests that the economic downswing is entering its final stage, with momentum likely to bottom during the second half of 2019 and revive in early 2020. This could set the stage for stronger EM performance next year, warranting a less defensive investment strategy. Currently, we prefer liquidity-sensitive markets likely to benefit from monetary policy easing and remain cautious on cyclical / commodity price exposure. Domestic monetary trends, meanwhile, suggest overweighting India, South East Asian markets, Poland and Greece, while underweighting Brazil, Mexico and Russia.

Global economic weakness was signaled by a significant fall in six-month real narrow money growth between July 2017 and October-November 2018. Allowing for an average nine-month lead, this suggested that the six-month rate of change of industrial output would peak in early 2018 and fall through the third quarter of 2019. This forecast continues to play out, with the six-month output change turning negative in April 2019, the latest available month – see first chart. The Markit / J P Morgan global manufacturing PMI, meanwhile, fell to a seven-year low in June.

Chart 1



Real narrow money growth has recovered since late 2018 but, as of May, remained weak by post-GFC standards. Monetary trends, that is, are consistent with global economic momentum reaching a low in the third quarter of 2019 but have yet to suggest a meaningful rebound. The judgement here is that six-month real money growth needs to rise to 3% (not annualised) during the second half of 2019 to confirm that 2020 will be a recovery year for the global economy. The 3% level was exceeded before all previous economic re-accelerations since the 2008-09 recession.

The forecasting approach does not attempt to predict monetary trends but there are reasons to be hopeful. Six-month nominal money growth reached a 16-month high in May and may be boosted by recent bond yield declines and central bank policy easing. Real money growth has been suppressed by a rise in six-month consumer price inflation, but this is likely to fall back, assuming stable commodity prices.

The forecast that the global economy would weaken in 2018-19 also rested on an assessment that the 3 - 5-year stock building (inventory) cycle and the 7 - 11-year business investment cycle were about to enter downswings that would continue into the second half of 2019 and possibly beyond.
Recent business survey evidence confirms weakness in the two cycles, but readings have yet to reach extremes suggestive of lows. The current working assumption here is that the stock building cycle will bottom in the third quarter of 2019 with the business investment cycle following one or two quarters later.

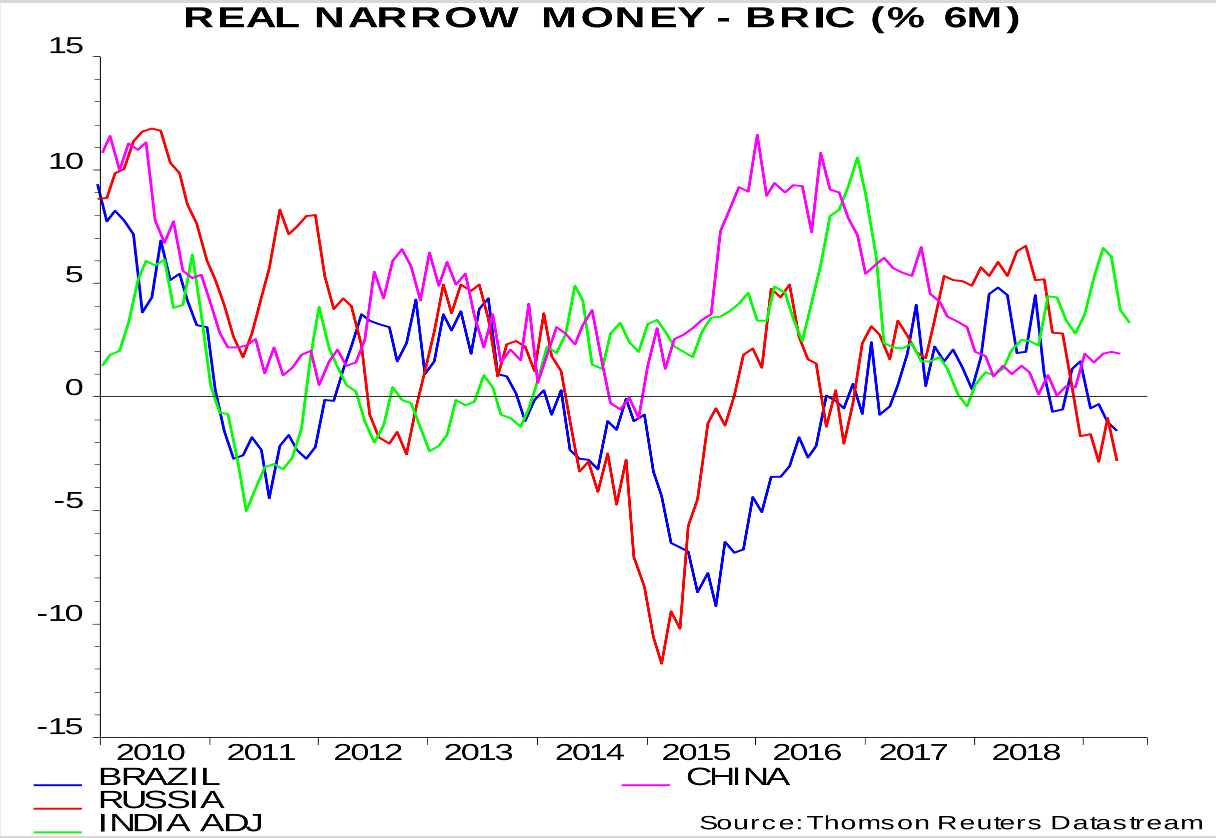
Economic weakness is now feeding through to labour markets and a rise in global unemployment is expected over the next 12 months even if an economic recovery begins in early 2020. Together with soft headline and core inflation, this will trigger belated and probably excessive monetary policy easing, laying the foundation for another bout of strong economic growth, possibly in late 2020 or 2021.

The above economic scenario suggests that a shift in investment strategy away from defense in favour of recovery plays may be warranted in late 2019 / early 2020. For the moment, our country selection emphasises liquidity-sensitive markets likely to benefit from Fed policy easing while continuing to underweight markets that have been positively correlated with the global economic cycle historically. Hong Kong-listed Chinese stocks and South East Asian markets are expected to be sensitive to lower US rates, while near-term further economic weakness may drag on Korea and Brazil, among others.

The recent sea change in Fed policy expectations has been mirrored by a dovish shift across EM central banks, despite headline inflation moving higher in many countries driven by energy / food prices. Official rates were cut in India, Malaysia, the Philippines and Russia last quarter, with falls expected soon in Brazil, Indonesia, South Africa and Turkey.

Chinese monetary developments will be important for timing any strategy shift. China led the global downswing – its Treasury yield curve (10-year versus 1-year) inverted in June 2017, 21 months ahead of the US. The PBoC relaxed monetary policy from mid-2018 and real narrow money growth has recovered but remains weak by historical standards – see Chart 2. As expected, recent economic data have disappointed consensus hopes of an early recovery and further easing is in train. This suggests better monetary news during the second half, which would confirm a 2020 economic rebound.

Chart 2



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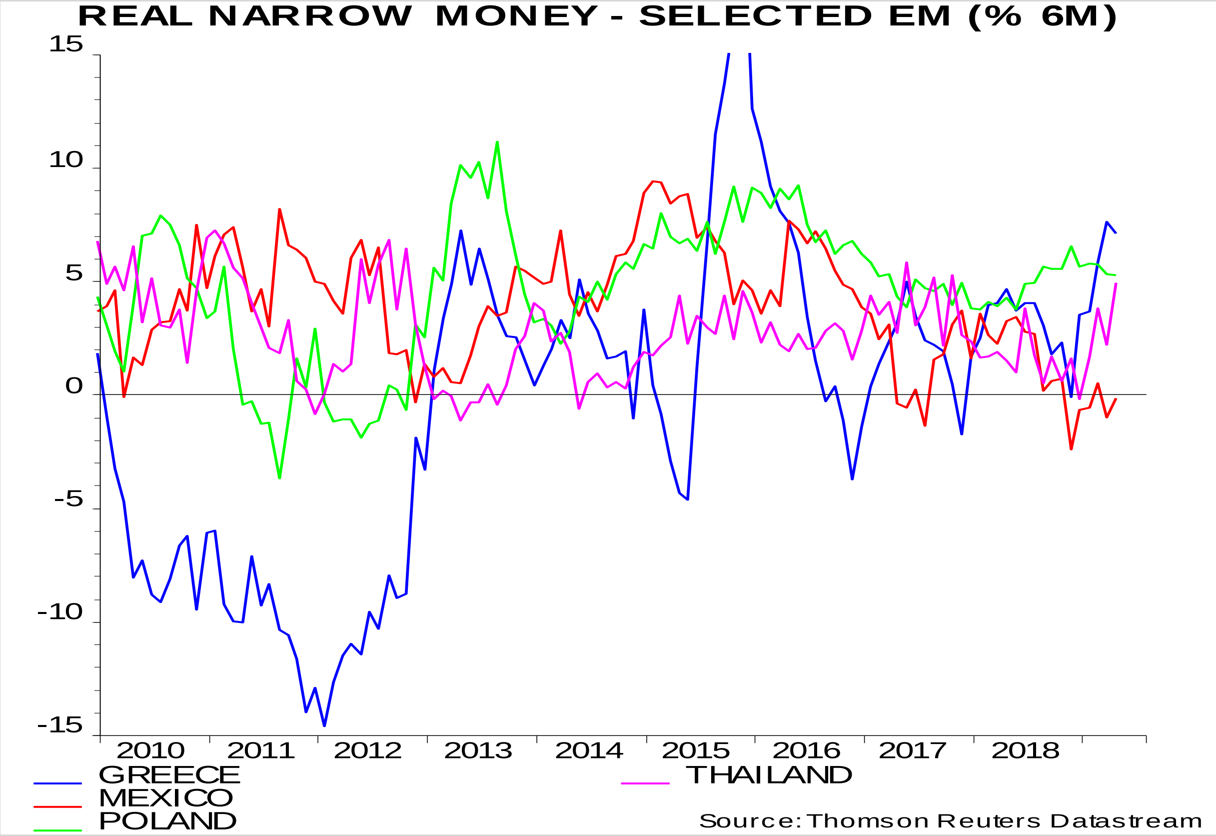
Of the large emerging economies, real money growth is currently strongest in India, though has cooled since the election – rate cuts may limit any further slowdown. Monetary trends remain negative in Brazil and Russia, suggesting that economic news will disappoint and arguing for urgent monetary policy easing, which could trigger currency weakness.

Elsewhere, real money growth has picked up in South East Asian countries, with Thailand in the lead, consistent with these markets benefiting from global liquidity loosening – see Chart 3 below. Money trends are strong in Greece, suggesting positive economic surprises, and remain solid in Poland, with potential further support from ECB policy easing. In Mexico, by contrast, Banxico policy appears to be excessively restrictive and monetary weakness could offset the usual boost to equities from falling US rates.

Chart 3



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