December 2018

Monthly Commentary

Global emerging markets update

- Emerging markets and currencies rise on easing trade tensions and Fed's dovish comments
- US and China agree on a 90-day trade truce
- Lower oil prices boost sentiment in India and Indonesia
- Mexico's central bank lift rates in view of President Lopez Obrador's controversial policies

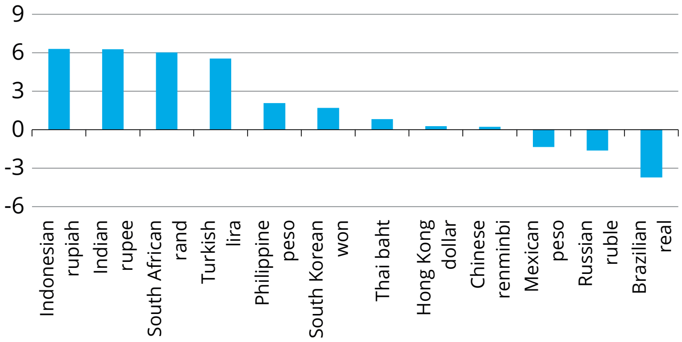
Market overview

Emerging markets and currencies enjoyed a reprieve in November, buoyed by a host of positive factors, including a flattish US dollar, easing trade tensions and falling oil prices.

The greenback came off the boil, following the Federal Reserve's suggested slower pace of policy tightening next year. Investors took heart from hopes that the US would agree to halt further levies imposed on Chinese exports for the next 90 days. In return, Beijing promised to reduce non-tariff barriers, tackle intellectual property theft and lower its trade surplus.

Some respite following a difficult October

Spot returns vs US dollar (%)



Source: Bloomberg, 30 November 2018

Meanwhile, oil prices were dented by fears of a supply glut and stuttering global growth. The Russian benchmark fell as a result, whereas India and Indonesia rebounded. Sentiment in India was also lifted by steady corporate earnings, despite the standoff between the government and the central bank. For Indonesia, markets welcomed policymakers' sixth rate hike this year, further stabilising the rupiah.

Turkish stocks and the lira rose after the US removed sanctions on two of its ministers. On the economic front, its current account balance for September swung to a surplus, compared to a deficit in the previous year.

In contrast, political developments and lower commodity prices dampened sentiment in Latin America. Mexico was additionally pressured by the incoming administration's proposal to scrap banking-services fees and construct several social projects following more controversial referenda, potentially aggravating the country's fiscal health. Citing concerns over the government's policies, the central bank raised interest rates and cut its growth forecast.

Monetary policy continued to tighten across markets. South Africa's central bank lifted its lending rates for the first time in two years amid a worsening inflation outlook, while Korea also raised its benchmark borrowing costs to address the increasing household debt level.

Outlook

Trade developments will shape the outlook of emerging markets in the year to come, while investors adjust to normalising monetary conditions and moderating economic expansion. Politics will also be a key driver, with investors keeping a close eye on progress by the administrations in Mexico and Brazil, as well as elections in markets such as Indonesia, India and South Africa. As the effect from the tax cut and fiscal stimulus fades, the US dollar is expected to ease further. Oil prices should stay in check on the back of pressure from the White House and an oversupply situation. Elsewhere, China's policy easing measures should prop up domestic consumption, while Beijing continues to liberalise the economy for foreign investment. At the corporate level, earnings expectations remain largely positive, and valuations appear undemanding. We stay cognisant of further volatility stemming from idiosyncratic risks and the trade tussle between Washington and Beijing, but take comfort in our holdings' improving fundamentals – their competitive business moats and prudent management should help them weather the broad-based uncertainty.

Aberdeen Standard Investments

What we've been up to

For the large-cap portfolio, we took advantage of share-price weakness to add to **Banorte** and **Tenaris**, while continuing to build our position in **Naspers**, which has an even more compelling valuation following the market correction with management focused on monetisation, free cash flow generation and a reduction in the discount. Against this, we top sliced **Lojas Renner** on post-election rally and **Asur**, considering potential risks from Lopez Obrador's administration. We trimmed **Naver** to raise cash after its weak results and reduced our exposure to **Gedeon Richter**. We pared **Truworths**, given the worsening economic backdrop, as well as **Ultrapar**, due to concerns over its strategy. We exited Standard Chartered, as its outlook remains difficult, characterised by weak credit growth and burdensome regulatory pressures, and its profitability has been increasingly challenged.

For the small-cap portfolio, we initiated **GHL Systems**, a Malaysian operator and distributor of payment terminals across Southeast Asia. In addition, we topped up Indian software company **Mphasis** on share-price weakness. Against these, we top-sliced Thailand's **Siam City Cement** on valuation grounds. We exited our positions in BRD Groupe and Iguatemi in view of better opportunities elsewhere.

Note: Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

Corporate News

Consumer: **BK Brazil** reported good results as performance normalised after the World Cup and the truckers strike.

BRF's margins were pressured by higher grain prices and one-off costs. Nevertheless, decent numbers in Brazil and the Halal segment mitigated poor results from its international markets, which were affected by restrictions in Russia and Europe.

BIM posted double-digit profit growth and expanded margins.

Financials: Growth in clients and average loan value boosted **ASA International**'s revenues. However, currency depreciation in India and Pakistan hurt profits, resulting in lower forecast.

Bank Pekao's results were better than expected, driven by robust loan growth in both retail and corporate divisions. Net-interest-margins also expanded. Separately, the lender will pay at least 90% of its net profits as dividend in 2018, and 60-80% next year.

Bradesco's net income rose, supported by a pickup in loan growth and improving asset quality.

Bank Central Asia also posted solid operational numbers. We think it has a promising outlook, given its sizable funding base, healthy asset quality and liquid balance sheet.

Housing Development Finance Corporation outperformed on good results. The lender reported solid growth in income and asset-under-management with stable asset quality. Moreover, the profits from the sale of HDFC Asset Management allowed it to set aside more for future contingencies.

Industrial: **Localiza**'s chairman resigned from the company as he will assume the position of Privatization Secretariat to incoming President Jair Bolsonaro.

John Keells will purchase 5% of its outstanding shares at 160 Sri Lankan rupees per share. It indicated that the current share price was not reflective of its future growth prospects. We view this buyback positively, given John Keells' solid balance sheet and net cash position. It also supports the stock, amid political uncertainties and economic sluggishness.

Real estate: **Parque Arauco**'s results exceeded estimates, with margins continuing to improve. Despite the deceleration in same-store-sales in Chile, operational numbers remained solid. On a separate note, the company will acquire El Bosque, an open plaza mall. The news was seen as marginally positive, as M&A remains a source of growth for the business in Chile.

Malaysian developer **SP Setia**'s earnings were weaker than expected, with lower revenue and higher costs due the frontloading of construction for new developments leading to reduced margins. While its valuations appear attractive, weak property market sentiment, poor earnings expectations and the delayed sale of the commercial assets in London's Battersea Power Station Phase 2 translate into a lack of near-term drivers for its share price.

Ayala Land's net profits grew, but pre-sales slowed. We are monitoring its mix of foreign and local buyers of property, as well as fourth-quarter numbers, given that sales tend to pick up in the last quarter of the year. Although its net gearing remains elevated, it is decreasing gradually.

Technology: **58.com** posted increased paid membership accounts; its net income was boosted by higher contribution from Zhuan Zhuan and lower-than-expected sales and marketing expenses.

Tencent's third-quarter net profits rose by 30%, driven by good growth from its advertising, mobile payments and cloud businesses. This offset sluggishness from its online games segment, which was to be expected, given Beijing's ongoing clampdown on online game approvals. While Tencent's immediate outlook will remain hostage to regulatory uncertainty, our investment case remained unchanged, given its quality ecosystem.

Telecommunications services: South African telecoms giant **MTN** and French peer Orange Group formed digital wallet operator Mowali, which will leverage on both companies' existing users, bringing together over 100 million accounts across 22 markets in sub-Saharan Africa.

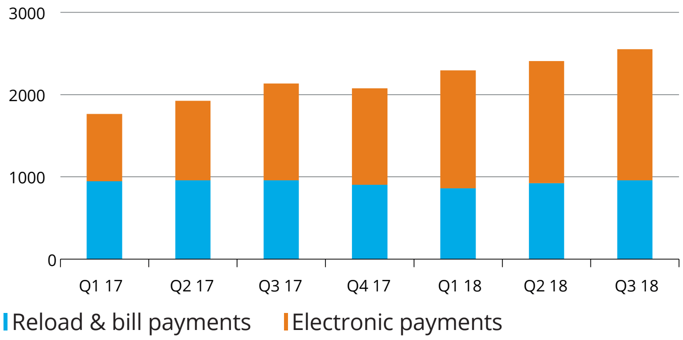
Focus: GHL Systems – all set for a cashless society

In November, we initiated GHL Systems, Southeast Asia's leading payment service provider, with key operations in Malaysia (its home market), Thailand, Vietnam and the Philippines. Its growth engine is the transaction payment acquisition (TPA) business, which drives more than half of its revenues. Its target markets are the under-served lower-tier merchants that record relatively less frequent transactions, but account for a larger total value. Over the years, it has built up a network of 310,000 point-of-sales terminals, and is now looking at entering new markets in search of fresh opportunities.

We like GHL for its solid balance sheet, with healthy free cash flow and a net-cash position; as well as its management, which possesses a good track record of following through on its strategy. Its valuation appears reasonable against regional and global peers.

Steady transaction payment value growth

Transaction payment value (RM mn)



Source: Company data, November 2018

The operating environment remains favourable, with regional trends shifting towards cashless settlements. For instance, Bank Negara Malaysia is actively investing in improvements in the relevant infrastructure, while increasing mandatory fees on cheque processing and lowering online money transfer charges. Authorities in Thailand and the Philippines also undertook similar initiatives. This has incentivised banks to partner with GHL, allowing it to expand its footprint through sales of supporting hardware and software.

We believe that GHL is well-placed to capture the accelerating e-transaction volumes and wider use of e-wallets, underpinned by positive changes in the industry and consumer preferences. We also find the tie-up with Alipay encouraging, as it reflects the high quality of GHL's platform and proves more profitable, removing the role of issuing banks. This should help mitigate the impact of falling transaction fees and pressure on margins in the longer term.

We hold the companies highlighted.

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