December 2018

Quarterly Commentary

Aberdeen Standard Emerging Market Equities

Economic and market review

Emerging markets retreated in the fourth quarter, but proved resilient relative to their developed counterparts, which suffered a sharp reversal of earlier gains. A confluence of factors, including simmering trade tensions, faltering global growth and the Federal Reserve's commitment to reducing its balance sheet weighed on sentiment.

Unsurprisingly, China fell sharply. Respite from the rapprochement with Washington seemed fleeting after Chinese telecom giant Huawei's CFO was arrested, and investors remained anxious over its impact on the outcome of the trade talks. The market was also hampered by jitters in the technology sector, which reeled from supply disruption worries, weaker-than-expected results from US majors and signs of a slowing domestic economy. To boost private consumption and investment, Beijing unveiled a raft of stimulus measures and slashed the reserve requirement ratio for commercial lenders. Other export-dependent markets, including Korea and Taiwan, also suffered from collateral damage, with contraction in overseas orders and manufacturing data.

More positively, oil prices eased, as OPEC's pledge to curb output was overshadowed by rising US shale production and expectations of falling demand. Indonesia and India rebounded as a result. For Indonesia, markets welcomed the central bank's sixth rate hike to manage a widening current account deficit, lending further support to the rupiah. India was resilient, shrugging off the ruling BJP's defeat in three key states and the stand-off between the government and the central bank that led to the resignation of its governor.

Meanwhile, political developments took centre stage in Latin America. Brazilian stocks and the real were boosted by right-wing Jair Bolsonaro's presidential victory and his market-friendly agenda that promised to uproot corruption and reform the country's burgeoning pension system. In contrast, Mexico's left-leaning President Lopez Obrador unnerved investors by scrapping the construction of the much-needed new airport after a controversial referendum, with further populist measures in the offing. Amid the heightened policy uncertainty and a worsening inflation outlook, the central bank lifted interest rates twice and lowered its growth forecast.

Outlook

While we do not underplay the risks, we feel recent emerging market concerns have been overdone and expect sentiment and our higher-quality holdings to recover. As the effect from the Trump tax cuts and fiscal stimulus fades, the US dollar should ease further. Despite a temporary US-China trade rapprochement, we think there will be prolonged tension and will continue to monitor developments. Meanwhile, China's policy easing measures should prop up domestic consumption to stabilise growth. Politics will also be a key driver, with investors keeping a close eye on progress by the new administrations in Mexico and Brazil, as well as elections in markets such as India, Indonesia and South Africa. At the corporate level, our holdings are businesses with healthy fundamentals, wide economic moats, and run by experienced management. With their solid balance sheets, they have been able to support improving returns to shareholders and their earnings forecasts remain positive, despite the short-term volatility.

Overall, we believe that the portfolio is well-positioned to withstand future challenges and capture the medium to long-term opportunities in emerging markets.

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