Quarterly Commentary

Emerging Markets Equity

During 2017 synchronized global growth and prevalent calm were main reasons for bullishness. However, last year volatility returned to the global markets in a very big way indicating expectations of ominous signs appearing on the horizon. While several early warning signs are starting to flash, none are consistent with an imminent collapse in world growth. The pace of growth is shifting to a lower gear, which is consistent with late cycle dynamics and should not choke off growth, despite less supportive monetary policy.

Emerging Markets are highly sensitive to global market conditions and many countries, such as Brazil, Argentina, Turkey and South Africa face unique headwinds that could be inflamed by the impact of developed market interest rate decisions and a stronger U.S. dollar. A sharp rise in inflation could be triggered if international interest rates are hiked significantly, which would likely hurt those countries, companies and sectors that operate with high leverage and have delicate liquidity needs. As well, there are several upcoming elections that have the potential to disrupt major markets like India, Indonesia and Argentina.

Last year was not kind to international stocks as they declined 12.5% in the fourth quarter and 13.4% for the year (all returns are in U.S. dollar terms). Europe, by a very small margin, was the worst culprit falling 13.0% in the quarter and 17.3% for the year. Not to be outdone, Asian stocks as a group declined by 11.5% during the last three months and 15.0% for the year. Surprisingly, Emerging Market stocks appear to have suffered most of their declines earlier in the year, as they were only down 7.4% in the quarter, but had a big annual decline of 14.2%.

Even though Chinese growth has been slowing recently, China is still a big consumer so getting its house in order is very important to the world. Of course, the biggest headache for China's policymakers is the more confrontational U.S. trade policy. China's will be proactive in heading off any worsening slump by using the fiscal tools under its control, whether that means cutting taxes or increasing the pace of local government bond issuance to finance infrastructure projects. Resolving the trade war and reversing China's economic slowdown are inextricably linked.

India's growth will remain strong ahead of upcoming general elections. Its economy has been supported by increased household spending and government consumption. Emerging Asia continued gradual slowdown is continuing due to escalating of trade tensions. Domestic demand will probably struggle across the region and could continue to weaken over the next couple of years.

Emerging Europe are a mixed bag with Russia starting to recover and Turkey's recession deepening as currency crisis and the dramatic rise in interest rates are likely to push the economy into a deeper recession than most expect. Across Latin America the Argentine peso has further to fall and that the risk of a sovereign default is quite large. Meanwhile, the recent raft of referendums initiated by Mexico should have a limited impact on growth. The European economy enjoyed its strongest performance for a decade in 2017 but cooled off in 2018. Quite simply, Europe's economy disappointed and lingering concerns remain. At first sight, alarm bells should be ringing, however the slowdown in Europe can be explained in large part by the disruption to the auto sector caused by the rollout of new emissions tests. Growth in much of Central and Eastern Europe has chugged along at a decent pace. Of course, there are issues: the winding down of the central bank's asset purchase program and the potential for rising interest rates; the U.K. stumbling toward agreement with the European Union over Brexit; trade tensions and the challenges posed by Italy's acute fiscal difficulties. Europe is fundamentally solid and while growth is moderate, it is not anywhere close to a recession.

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