



Emerging Markets

# Quantitative Market Monitor

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MarketQuant Research

Quarterly - 2017 Q2

*Extracts from the original document*



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## Macro scenario for EM

### **Firming growth in EM up to the first half of 2018.**

The short-term cyclical acceleration or positive growth in the US and the Eurozone coincide with an uptick in trade volumes; positive demand spillovers for the global economy result in: (1) China's cyclical stabilization with persistent policy support; (2) high growth in some attractive EM e.g. India despite the demonetization, and Indonesia; (3) a confirmation of the exit from recession for Russia and Brazil, even though it will be more gradual than expected for the latter; and (4) the stabilization at a more favorable level or rebound in oil and commodity prices improving the situation of commodity producers/exporters.

### **Fx and domestic financial conditions to be more stable over the short-term after pressures toward the end of 2016 following D. Trump elections.**

Tighter US monetary policy and contained USD strength are not expected to trigger large or sustained downward pressures on EM currencies during the next few quarters, as EM benefit from an improvement in growth outlook, more neutral exchange rate valuations and stronger foreign currency reserves. However, the US tightening will progressively reduce policy flexibility and impose likely reversal later in 2017 or early 2018. Among the ten key EM currencies, ZAR and TRY are more vulnerable, though the former is supported by higher commodity prices and exports.

### **EM monetary stance to remain accommodative during most of 2017.**

The recent stabilization / appreciation of EM currencies is reducing constraints on domestic monetary policies. Despite the acceleration in PPI inflation, CPI figures have remained more stable as pass-through effects have been more positive and administrative price adjustments were done in previous quarters. Our aggregate policy reaction function for our 10 key EM suggests a stabilization in most policy rates over the coming months. Easing should continue in countries exiting recession (Brazil, Russia), while in others, real interest rates are likely to decline with the following uptick in inflation. A clear reversal towards tightening should be expected during 2018.

### **Low risk materialization for key EM in 2017, but differentiation increases again.**

Our Economic & Financial Risk ratings point to (1) persistently low probability of cyclical, currency and payment risk materialization during most of 2017, and (2) a growing differentiation among EM for 2018 and beyond. The differentiation is visible when comparing the 10 key EM (stable average risk rating after a mild deterioration in 2016) with the entire EM universe (95 countries), for which the deterioration is larger and lasting, pointing to higher risk materialization in 2018. Risk is also divergent within the 10 key EM, Russia showing a massive improvement while others are more stable.

## Markets' performances and outlook

**Markets' performances**  
positive performances for equity; no downward shock for fixed income despite US tightening

Both Equity and Fixed Income markets across the EM universe have continued their one-year old improvement over the past months, despite the hike in US Fed Fund rates and ongoing US monetary policy tightening and increase in US long-term interest rates.

- The strong pick up in EM equity markets is reflected in an MSCI-EM index above 950 in March 17 from 926 three months before and 872 a year before, i.e. +15% over a year, against 12% for developed markets. The increase in the MSCI-EM index occurred with a decline in daily volatility, indicating a rather strong momentum, though the average price-earnings ratio has now moved back to its long-term average: not yet overvalued but having already made the catch-up that was evident e year ago.
- The global FX EM bond (measured by the JPMorgan EMBI+) spread over US Treasuries has substantially declined over the past year, but has however stabilized over the last quarter at about 50bp below its 3-year average.
- The EM LC Bond (measured by JP Morgan GBI-EM Broad Index) market has been roughly stable between Nov. 16 and Mar. 17, though it has increased modestly during the last weeks of 2017Q2. The (negative) spread with US High Yield securities has compressed over the last 3 months and is now significantly lower than its 3-year average (i.e. more attractive).

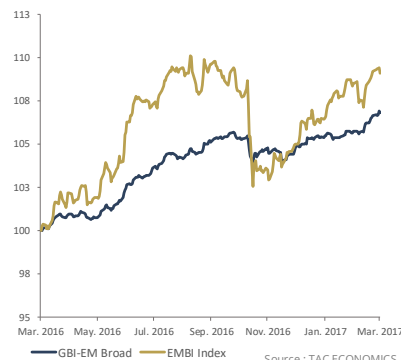
MSCI (base: Mar. 2016 = 100)



EMBI+ Spread



GBI-EM Broad (base: Mar. 2016 = 100)



Markets' performances are broadly in line with our macroeconomic view, namely firming growth and low risk materialization for key EM in 2017 (China's cyclical stabilization, high growth in India and Indonesia, exit from recession for Russia and Brazil...). The pressures following D. Trump election subsided and the hike in Fed Fund rates did not imply deterioration in fixed income markets.

### Country Risk measures

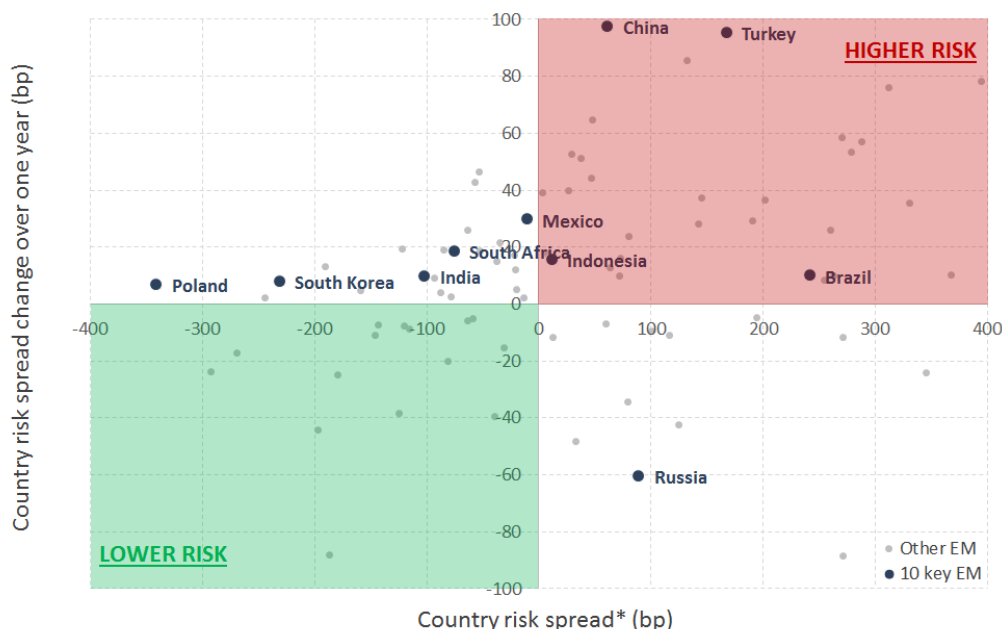
China, Turkey and Brazil show poorer country risk dynamics or levels; massive improvement in Russia

TAC ECONOMICS' broadest measure of country risk is a global Country Risk Premium (or Risk-Related Extra Cost of Capital, expressed in basis points) that incorporates currency, cyclical, payments and political risk ratings and signals.

On the chart below, we plot the positions of our 10 key EM regarding the difference or spread between our Global Country Risk Premium and JP Morgan EMBI+ global spread (i.e. a relative measure of country risk against markets' average valuation, on the horizontal axis), and the one-year dynamics for the same relative risk measure. Countries most at risk are located within the upper right corner of the graph, and the countries with the lowest risk at the bottom left.

The higher country-risk area includes notably China, Turkey and Brazil; no country among the 10 key EM is in the most favorable bottom-left area of the chart, though Poland, South Korea, India and Russia show more favorable positions.

Country Risk: level vs dynamics



\* difference between TAC ECONOMICS RRECC and 12-month average EMBI spread

Source : TAC ECONOMICS

Turkey, Brazil as well as China show both elevated Economic & Financial Risk ratings and very high vulnerability to unexpected shocks or events, as evidenced by WatchList Indications on Exchange Rate for all three countries, though at highly different time-horizons (shorter-term for Brazil, end of 2017, 2018 or even after for Turkey and China).

Russia exhibits a strongly improving Economic & Financial Risk rating, reflecting the ongoing exit from recession. The low macroeconomic risk is however associated with the highest Political Risk rating among the 10 key EM.

India, Indonesia, South Africa and Mexico show average and slightly deteriorating country risk spreads. However, the positive reversal in their Risk ratings over the last quarter suggests that the country-risk outlook will become more favorable towards end-2017 and 2018.

### Aggregate Valuation & Risk Metrics

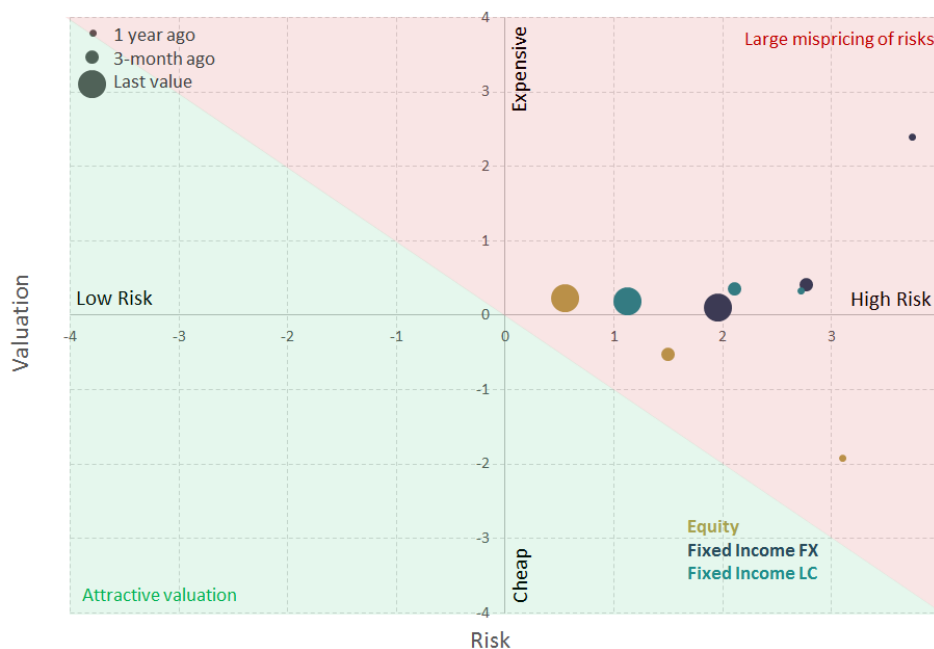
Fixed Income LC more vulnerable to mispricing of risks; other markets close to neutral Risk-Valuation position

Valuation and Risk confrontation or comparison is the core of the Quantitative Market Monitor. It is based on composite indexes, for both valuation (including the traditional indicators such as Price-Earning or Price-to-Book for equities, spreads over benchmarks for fixed income, as well as shorter-term valuation / dynamics indicators) and Risk (including our country risk measures as well as shorter-term financial risk variables). All Valuation and Risk indexes are statistically normalized and scaled from -12 (cheapest valuation, lowest risk) to +12 (most expensive, highest risk).

Using these Valuation and Risk indexes for the aggregate 10 key EM, we highlight the following:

- Equity Markets have been moving alongside a neutral Valuation / Risk line since early 2016, with a visible improvement in Risk (irregularly) associated with rising Valuation. The overall measure is now very close to a fully neutral value (0.55 on risk, 0.23 for valuation) and dispersion across countries has narrowed with all countries close to the neutral line.
- Fixed income FX markets have shown attractive dynamics since Jan.16: our Valuation index is improving rapidly, now much closer to “cheap” area, while the composite Risk index is modestly trending down. Though the aggregate position is not yet in the most attractive area, the combination Valuation – Risk is now better than during the past year. Country positions are more scattered, especially regarding Valuations.
- Fixed income LC markets are showing an irregular clockwise movement in the *mispricing of risks* area. Aggregate Valuation appears fully neutral, but this is not reflecting slightly higher degree of Risks for such markets, probably including larger-than-expected currency risks on the medium-term.

Aggregate Valuation and Risk Metrics



Source : TAC ECONOMICS

### Key messages at market and country levels

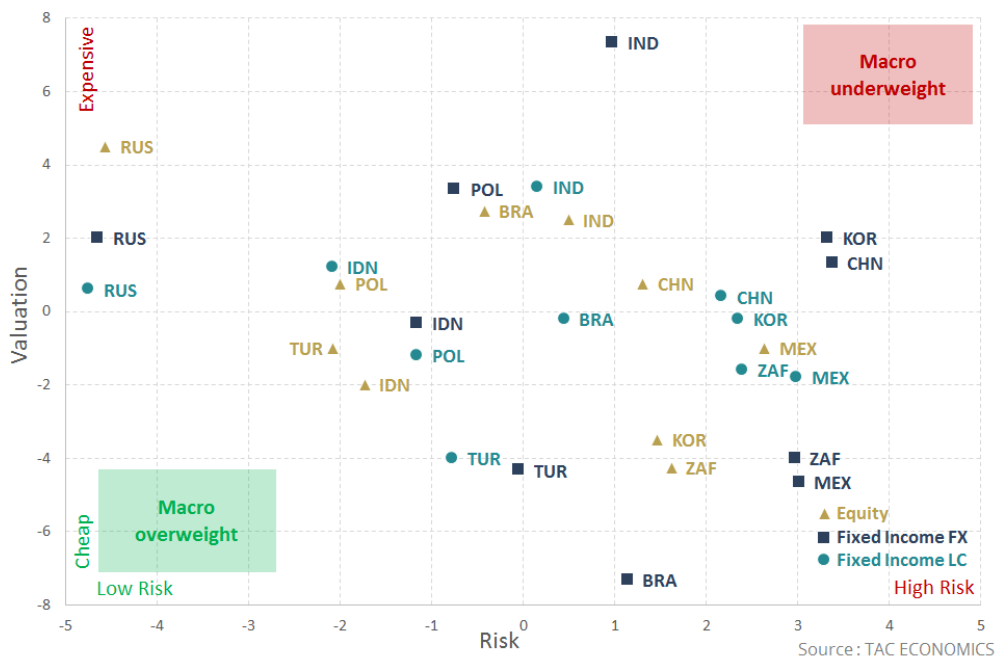
Turkey and Russia to be looked at; caution on Asian fx fixed income markets

We detail here the positions of countries and markets in the same Risk-Valuation approach. Overall, the 30 markets (3 markets for each of the 10 EM) are almost equally distributed in the four quadrants of our Risk – Valuation chart. Dispersion across markets is larger for Valuation than for Risk.

Recent economic and financial indicators have a significant influence on individual markets’ Risk indexes: in the case of **Turkey**, positive short-term cyclical indicators and performances are still offsetting a much worse country-risk reading, suggesting a more tactical approach for exposure to Turkish assets and a more negative medium-term view. In parallel, **Russia’s** visible exit from recession in a context of better energy prices and an appreciating currency lead to very minor differences across Risk Readings at very attractive levels; except for Equity prices, Valuation has not yet fully caught up with this improved risk background.

The analysis also reveals large mispricing Fixed Income FX risks in Asia (India, Korea, China), partly reflecting stronger economic momentum still so far associated with stable or easing monetary policies and a progressive resurgence of inflationary risks, particularly sensitive in the context of expected US monetary tightening. As exchange rates were much more in line with fundamentals and have not been so far affected by the US tightening, this combination has induced much higher risks for **China** and **Korea**, and excessive Valuation in **India**. In Asia, **Indonesia** shows a better position for all three markets.

Full markets’ risk and valuation map



Markets in **Brazil, Mexico** and **South Africa** are almost all in a more “neutral” Risk – Valuation combination, though FX Fixed Income is always more attractive than the other asset classes (with a nuance for South African equities: South African markets are in all cases caught between the positives of rising or higher commodity prices and exports, and more acute political uncertainties after the dismissal of the country’s Minister of Finance).

In **Poland**, the expected “pull-factor” from the economic improvement in the Eurozone and favorable country risk measures combine with almost neutral Valuation readings, with a more attractive combination for LC Fixed Income as well as Equities.



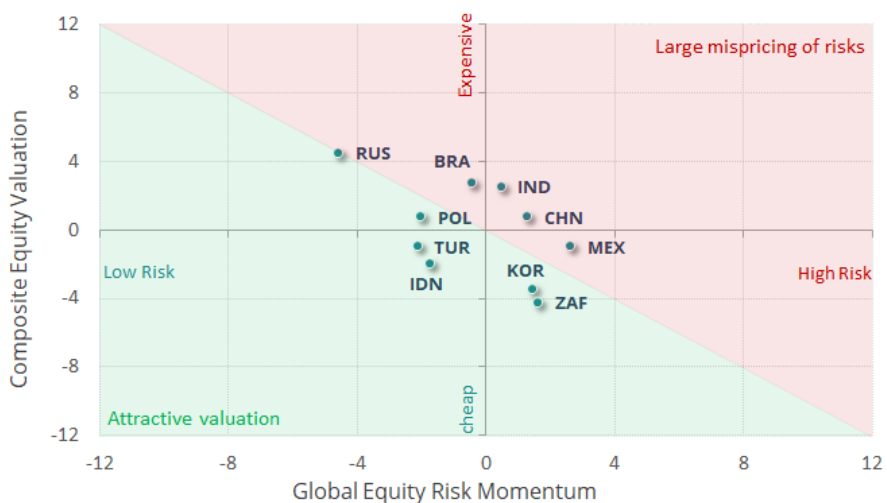
## **Overall Performance and Risk Metrics**

# Equities - Valuation & Risk Metrics for 10 key EM

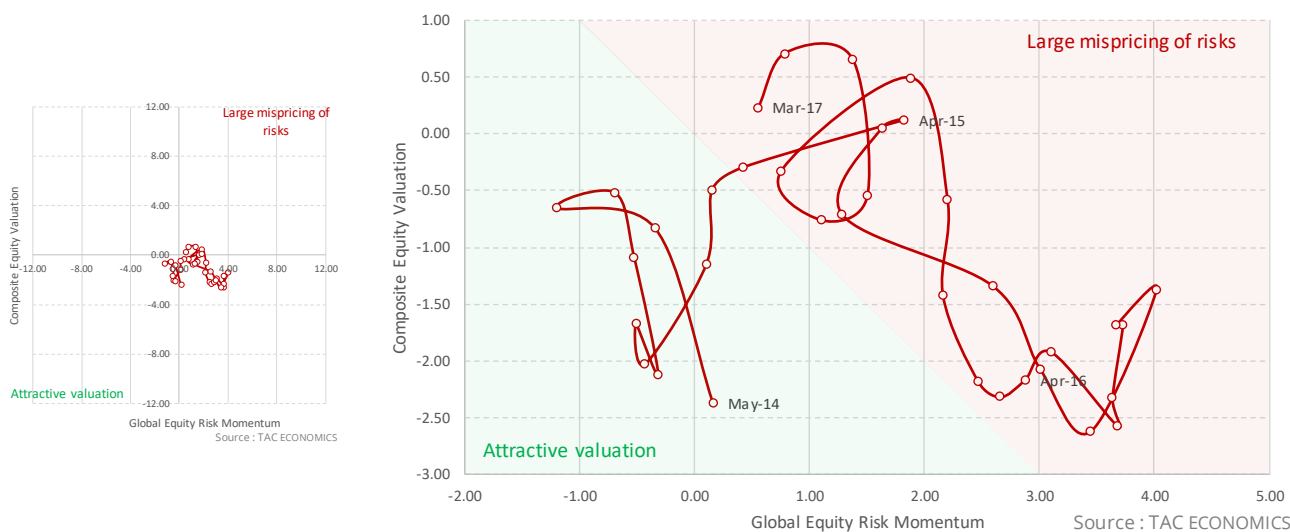
Quantitative table	-12 cheap to +12 expensive		-12 low risk to +12 high risk		
	Composite Equity Valuation	Global Equity Risk Momentum	Cyclical Risk Momentum	Currency Risk Momentum	Liquidity Risk Momentum
Brazil	2.8	-0.4	-3.3	-0.1	1.7
China	0.8	1.3	-3.0	2.1	2.9
India	2.5	0.5	-2.0	4.0	-2.4
Indonesia	-2.0	-1.7	-3.8	-0.8	-3.7
Mexico	-1.0	2.6	2.7	0.5	4.5
Poland	0.8	-2.0	-4.2	-1.7	0.2
Russia	4.5	-4.6	-3.8	-7.6	-4.0
South Africa	-4.3	1.6	-1.2	3.2	3.1
South Korea	-3.5	1.5	-3.3	6.5	1.7
Turkey	-1.0	-2.1	-5.2	-3.6	2.1

Source: TAC ECONOMICS

## Equity Markets' Valuation and Global Macro Risk - latest

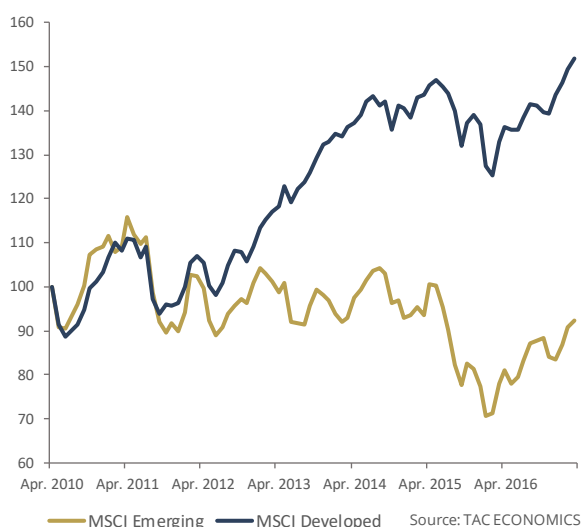


## Equity Markets' Valuation and Global Risk – overall dynamics 10 key EM

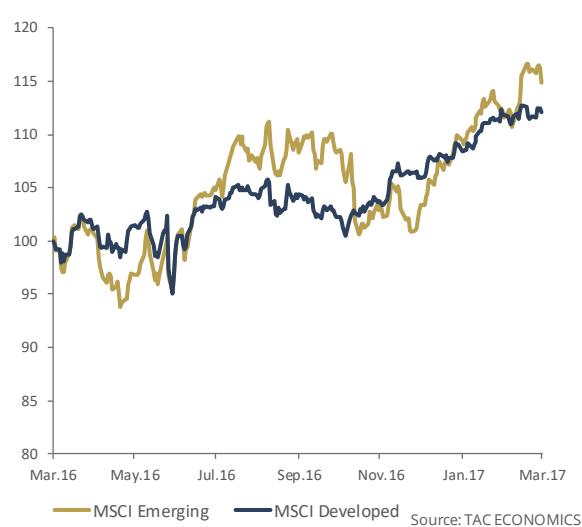


# Equities - Overall EM performance

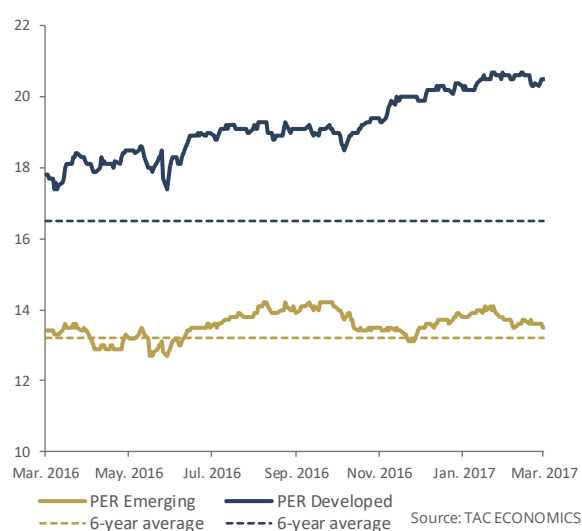
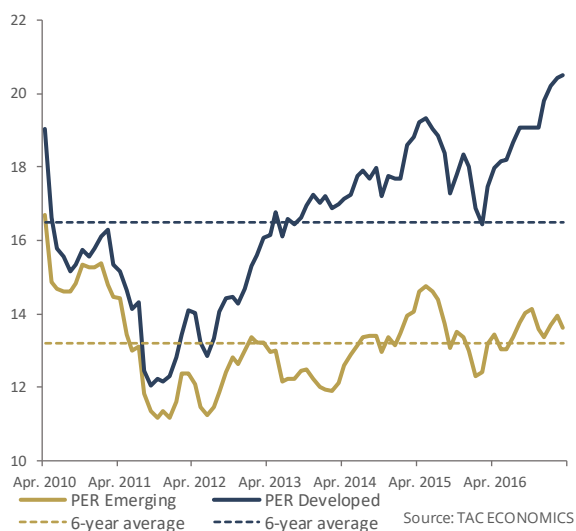
**MSCI Emerging Market and Developed Market**  
(monthly, index rebased Apr. 2010 = 100)



**MSCI Emerging Market and Developed Market**  
(daily, index rebased Mar. 2016 = 100)



**Price Earning Ratio for MSCI Emerging and Developed Markets** (monthly and daily)



Quantitative table	Last month (Mar-17)	Average 3 months	Average 12 months	Average 3 years
MSCI Index Value	952	926	872	919
EM/DM Ratio index	61%	60%	60%	64%
PER EM	13.6	13.7	13.5	13.5
Differential PER EM-DM	-6.9	-6.6	-5.5	-4.9
MSCI Index Volatility (daily/3 months)	59%	64%	88%	88%
Differential Volatility EM-DM	23%	27%	25%	21%

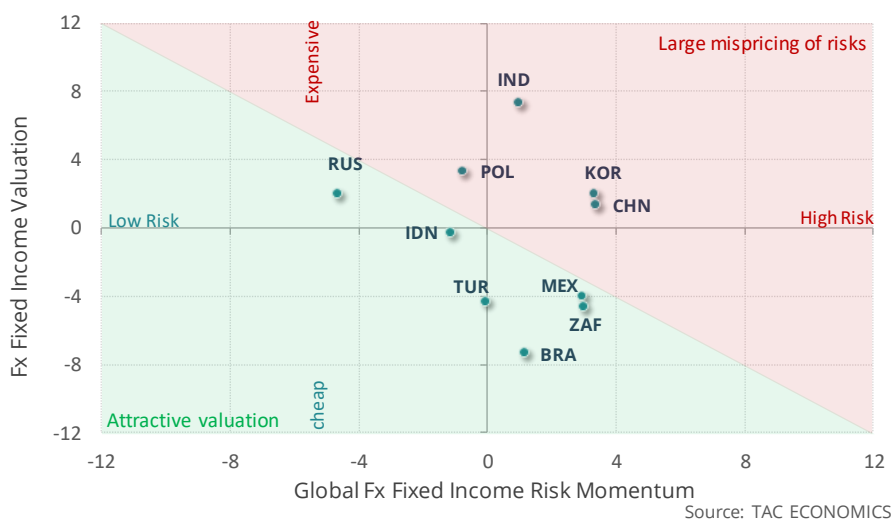
Source: TACECONOMICS

# Fixed Income Fx - Valuation & Risk Metrics for 10 key EM

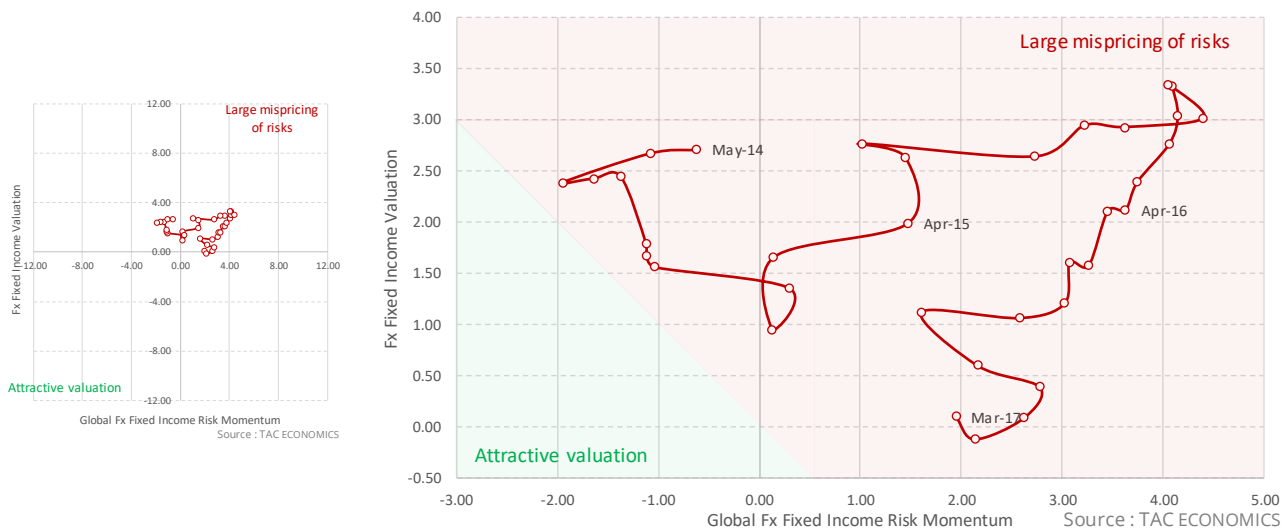
Quantitative table	-12 cheap to +12 expensive	-12 low risk to +12 high risk			
	Fx Fixed Income Valuation	Global Fx Fixed Income Risk Momentum	Cyclical Risk Momentum	Currency Risk Momentum	Liquidity Risk Momentum
Brazil	-7.3	1.14	-3.3	-0.1	1.7
China	1.3	3.4	-3.0	2.1	2.9
India	7.3	1.0	-2.0	4.0	-2.4
Indonesia	-0.3	-1.2	-3.8	-0.8	-3.7
Mexico	-4.7	3.0	2.7	0.5	4.5
Poland	3.3	-0.7	-4.2	-1.7	0.2
Russia	2.0	-4.6	-3.8	-7.6	-4.0
South Africa	-4.0	3.0	-1.2	3.2	3.1
South Korea	2.0	3.3	-3.3	6.5	1.7
Turkey	-4.3	0.0	-5.2	-3.6	2.1

Source: TAC ECONOMICS

## Fixed Income FX Valuation and Global Risk - latest

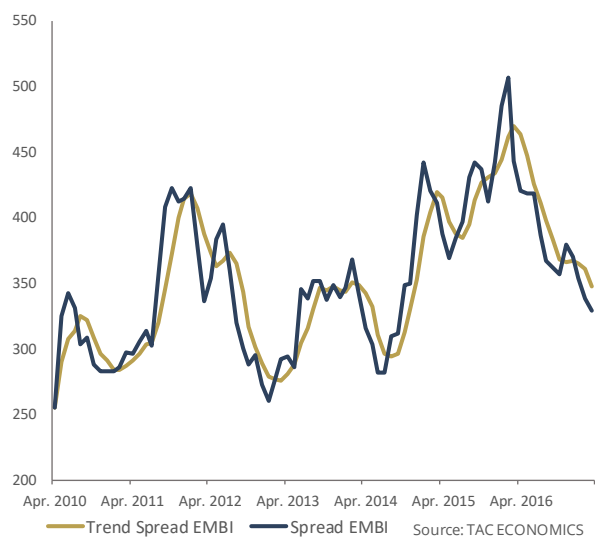


## Fixed Income FX Valuation and Global Risk – overall dynamics 10 key EM

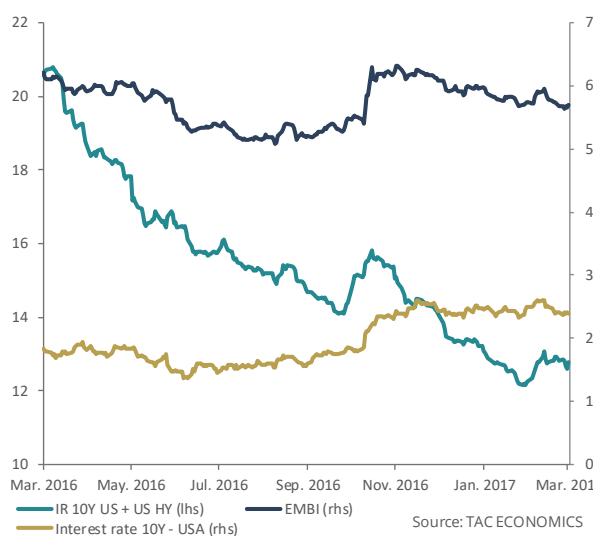
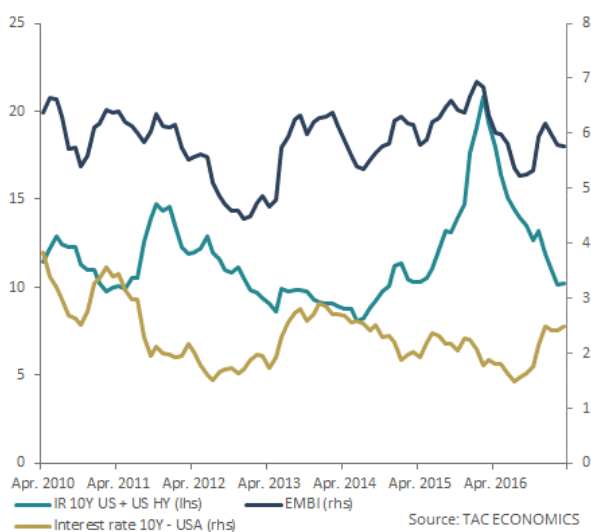


# Fixed Income Fx - Overall EM performance

**EMBI+ Spread with trend (monthly and daily)**



**EMBI vs US Highyield and US Treasuries (monthly and daily)**



**Quantitative table**

	Last month (Mar-17)	Average 3 months	Average 12 months	Average 3 years
EMBI Global Composite Return Index	764	757	743	697
EMBI Spread in bp	329	340	380	383
Differential EMBI-US High Yield in bp	-444	-460	-806	-646
Index Volatility (daily/1 month)	7.7%	6.4%	7.5%	7.4%
Differential Volatility EMBI-US 10yTB	6.4%	5.3%	6.2%	5.9%

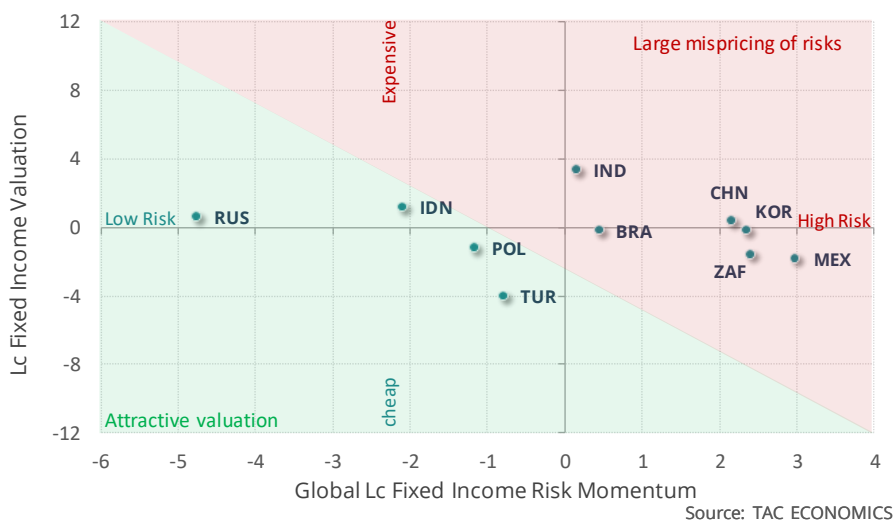
Source: TAC ECONOMICS

# Fixed Income LC - Valuation & Risk Metrics for 10 key EM

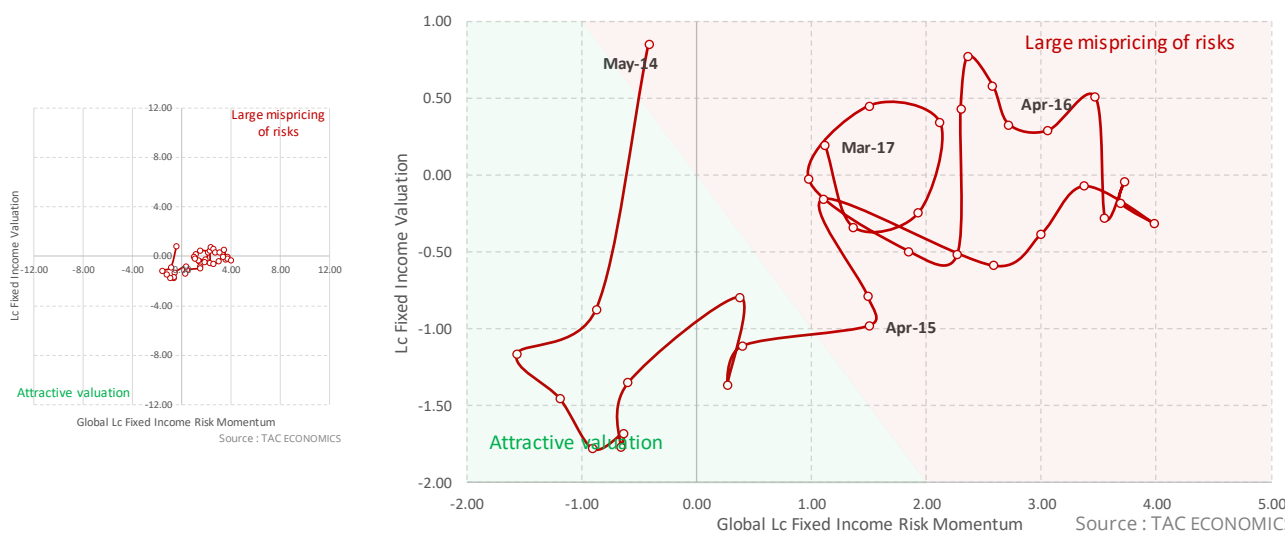
Quantitative table	-12 cheap to +12 expensive		-12 low risk to +12 high risk		
	Lc Fixed Income Valuation	Global Lc Fixed Income Risk Momentum	Cyclical Risk Momentum	Currency Risk Momentum	Liquidity Risk Momentum
Brazil	-0.2	0.4	-3.3	-0.1	1.7
China	0.4	2.2	-3.0	2.1	2.9
India	3.4	0.2	-2.0	4.0	-2.4
Indonesia	1.2	-2.1	-3.8	-0.8	-3.7
Mexico	-1.8	3.0	2.7	0.5	4.5
Poland	-1.2	-1.2	-4.2	-1.7	0.2
Russia	0.6	-4.7	-3.8	-7.6	-4.0
South Africa	-1.6	2.4	-1.2	3.2	3.1
South Korea	-0.2	2.4	-3.3	6.5	1.7
Turkey	-4.0	-0.8	-5.2	-3.6	2.1

Source: TAC ECONOMICS

## Fixed Income LC Valuation and Global Risk - latest

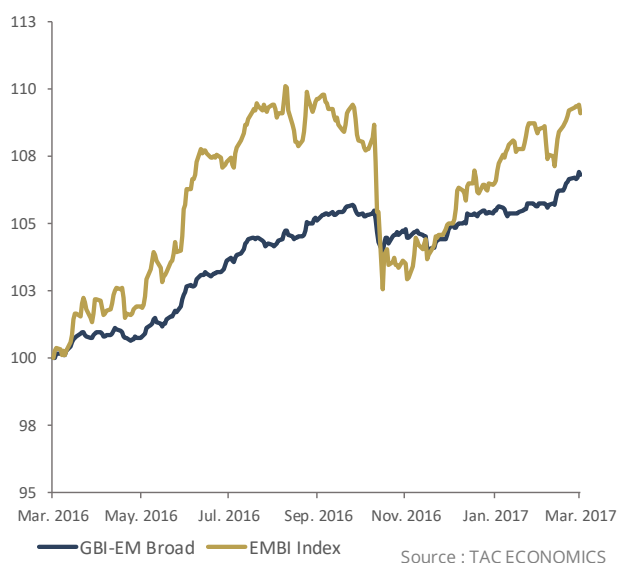
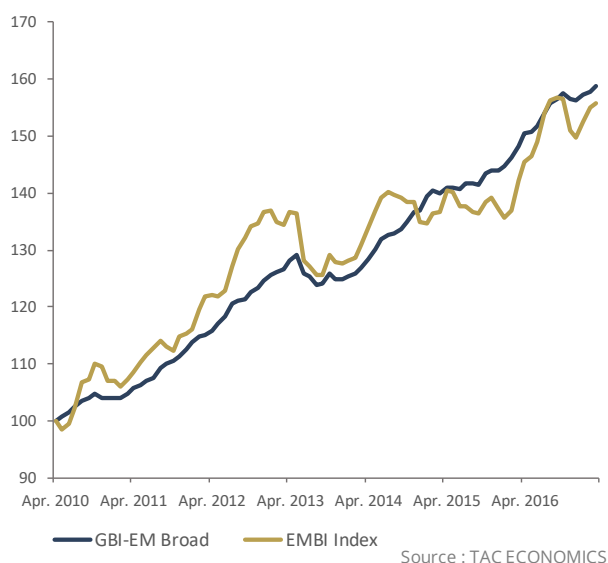


## Fixed Income LC Valuation and Global Risk - overall dynamics 10 key EM

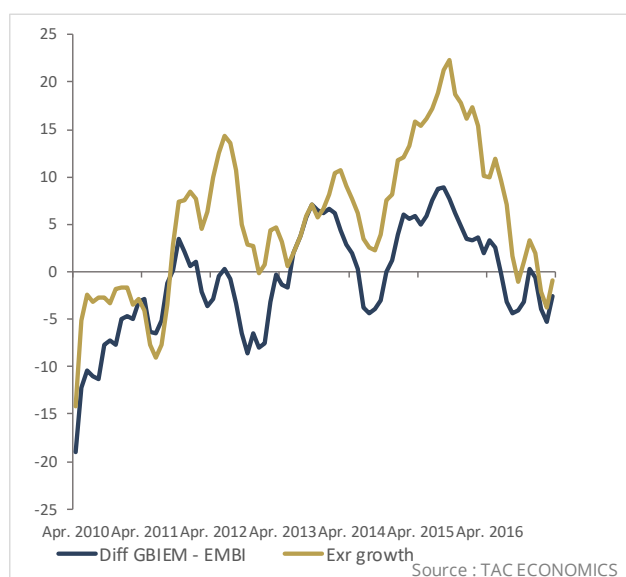


# Fixed Income LC - Overall EM performance

**GBI-EM Broad vs EMBI** (monthly index rebased Apr. 2010 = 100 and daily index rebased Mar. 2016 = 100)



**Exchange rate growth vs differential GBIEM-EMBI indexes** (monthly and daily)



Quantitative table	Last month (Mar-17)	Average 3 months	Average 12 months	Average 3 years
GBI-EM broad index	313	311	305	284
Estimated GBI-EM spread in bp*	454	542	633	494
Est. differential GBI EM - US High Yield in bp	-319	-259	-507	-546
Index Volatility (daily/1 month)	9%	10%	10%	11%
Differential Volatility GBIEM-US 10yTB	-7.6%	-6.3%	-7.4%	-7.3%

Source: TAC ECONOMICS

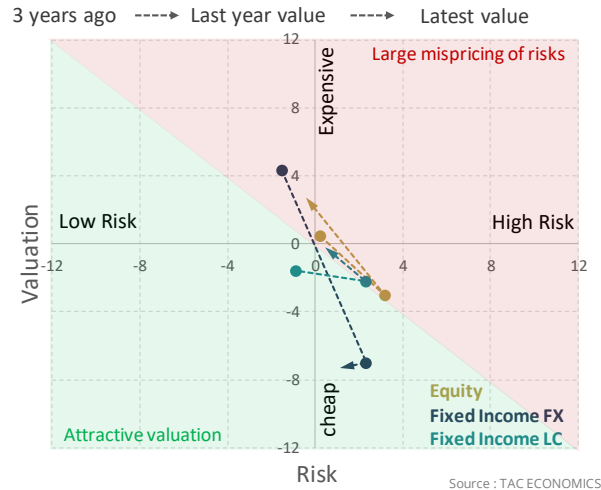
\* Estimated GBI-EM spread is computed as the differential between the annual growth rate of GBI-EM index and 10Y US Treasuries.

## **Individual Country Performance and Risks**



# Brazil

## Valuation and Risk



## Macro Risk & Valuation Metrics Global summary

-12 cheap to +12 expensive

Valuation Metrics	Latest	1y ago	3y avg
Equity Markets	2.8	-3.0	-0.9
Fixed Income Fx	-7.3	-7.0	-3.2
Fixed Income LC	-0.2	-2.2	-1.4

-12 low risk to +12 high risk

Risk Metrics	Latest	1y ago	3y avg
Equity Markets	-0.4	3.2	1.6
Fixed Income Fx	1.1	2.3	0.7
Fixed Income LC	0.4	2.3	0.7

-12 low risk to +12 high risk

Risk Components	Latest	1y ago	3y avg
Cyclical Momentum	-3.3	5.3	3.4
Currency Momentum	-0.1	-1.5	-2.7
Liquidity Momentum	1.7	2.3	1.0

## Summary Equity Markets

	Latest	1m ago	3m ago	1y ago	3y avg
MSCI index*	22 346	22 911	20 576	17 669	19 385
Change %		-2.5%	8.6%	26.5%	15.3%
PER	16.3	17.3	15.5	13.0	14.0
PB	3.92	4.05	3.86	4.10	3.87
Volatility, %	10.6%	10.3%	9.8%	9.4%	7.4%

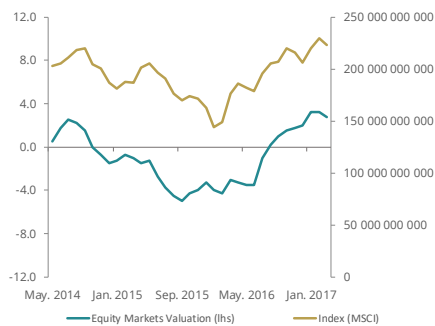
## Summary Fixed Income Fx

	Latest	1m ago	3m ago	1y ago	3y avg
Spd EMBI	271.9	278.3	332.5	454.4	330.3
Change %		-2.3%	-18.2%	-40.2%	-17.7%
Volatility, %	28.3%	28.5%	29.2%	34.7%	25.1%

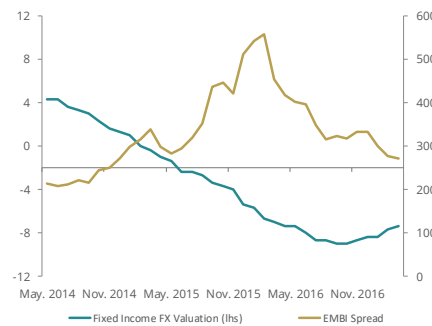
## Summary Fixed Income LC

	Latest	1m ago	3m ago	1y ago	3y avg
Yield	10.3	10.4	11.8	14.4	12.8
Spd US, bp	777	800	935	1251	1068
Change, bp		-16	-158	-414	-258
Volatility, %	12.0%	11.4%	10.8%	13.1%	11.6%

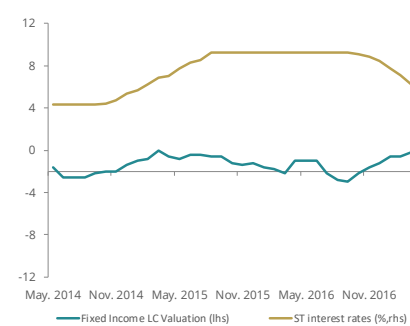
### Equity markets valuation and MSCI



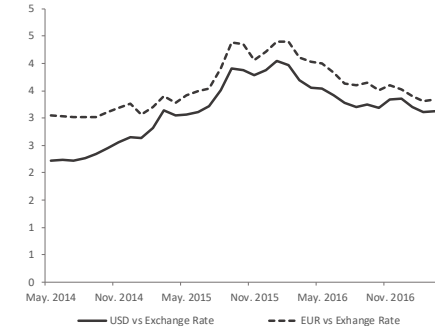
### Fixed Income Fx valuation and EMBI



### Fixed Income LC valuation and short-term interest rates



### EUR and USD vs BRL



\*Unit = 10 mn for Brazil and 100 for Turkey

Data up to Mar-17