

Global Emerging Markets Opportunities Fund

Emerging Markets Spotlight

James Syme, Senior Fund Manager | Paul Wimborne, Senior Fund Manager

April 8, 2020

Country-level remains our focus when thinking about risks and opportunities in Emerging Markets (EM) equity, but we are also aware of developments at the sector and industry level.

At this time, a development that seems particularly important to us is the rapidly worsening outlook for banks – both in emerging markets and globally.

We wrote two weeks ago that “banks generally carry a triple threat in this environment”. We now update that to four threats, which we discuss below.

Firstly, banks are inherently cyclical businesses. Loan growth is a reflection of animal spirits in the economy, whether corporate or household, while the fee component of income is also driven by activity levels. Further down the income statement, provisions (cost of risk) is hugely counter-cyclical, peaking around the economy’s weakest point.

It is unclear at this time exactly how bad the hit to top line and provisions will be from the coronavirus-related economic slowdown. But moves in high yield and credit default swaps suggest it will be severe. Banks that carry investment portfolios and/or financial inventory on their balance sheets will be further impacted by the ongoing hit to asset prices. Although regulatory forbearance can shield capital adequacy from these effects, it cannot shield reported earnings.

Secondly, fee income is the minor part of revenue for most banks. The major part is interest income. As interest rates decline – and particularly as deposit and funding rates approach the zero lower bound – net interest margins are compressed. This can have a severe impact on bank profitability. It’s often then reflected in price-to-book ratios of banks in low-rate environments, as seen in recent years in Japan, Korea, Taiwan and the eurozone.

Thirdly, and a new feature of the landscape, central banks and regulators in many countries are putting pressure on banks to grant repayment holidays on various types of credit. Many emerging markets – including Thailand, South Africa, Turkey, Hungary, Mexico, Colombia, India and UAE – have seen banks offer delayed payment terms for interest and/or principal. While this may reflect delay rather than negotiation of cashflows, it is clearly unhelpful, and also raises the possibility of further forbearance such as underpricing of loans and/or debt jubilees – all of which are risks to banks and their shareholders.

Finally, possibly the most serious development is the move in some countries to ban dividends and buybacks for banks (and potentially for insurers). While this is more of a developed market phenomenon so far (with the eurozone, the UK and New Zealand the first countries to do this), it clearly has the potential to be adopted by other countries. Doubts about payouts to shareholders are very likely to depress the valuation given to bank equity shares, in turn increasing the risk that any capital raise will be dilutive.

It is abundantly clear that pretty much every sector – indeed pretty much every form of human activity – is severely affected by coronavirus and the social and economic impacts of efforts to control the virus. However, within that, we see a particularly negative outlook for banks, and potentially other highly-regulated financials such as insurers. We are about maximum underweight financials relative to benchmark at the time of writing.

JOHCM Global Emerging Markets Opportunities Fund

5 year discrete performance (%)

Discrete 12 month performance (%):	31.03.19	31.03.18	31.03.17	31.03.16	31.03.15
A USD Class	-21.17	-2.55	20.18	18.95	-13.11
Benchmark	-17.72	-7.36	24.13	17.59	-11.92
Relative return	-4.19	5.19	-3.18	1.16	-1.35

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg, NAV of Share Class A in USD, net income reinvested, net of fees as at 31 March 2020. The A USD Class was launched on 30 June 2011. Benchmark: MSCI Emerging Markets NR (12pm adjusted). Performance of other share classes may vary and is available on request.

PENDAL

For more information contact your
key account manager or visit pendalgroup.com

This document has been prepared by Pental Funds Services Limited (PFSL) ABN 13 161 249 332, AFSL No 431426 and the information contained within is current as at 8 April 2020. It is not to be published, or otherwise made available to any person other than the party to whom it is provided. This document is for general information purposes only, should not be considered as a comprehensive statement on any matter and should not be relied upon as such. It has been prepared without taking into account any recipient's personal objectives, financial situation or needs. Because of this, recipients should, before acting on this information, consider its appropriateness having regard to their individual objectives, financial situation and needs. This information is not to be regarded as a securities recommendation. The information in this document may contain material provided by third parties, is given in good faith and has been derived from sources believed to be accurate as at its issue date. While such material is published with necessary permission, and while all reasonable care has been taken to ensure that the information in this document is complete and correct, to the maximum extent permitted by law neither PFSL nor any company in the Pental Group accepts any responsibility or liability for the accuracy or completeness of this information.

PFSL is the responsible entity and issuer of units in the Pental Global Emerging Markets Opportunities Fund ARSN: 159 605 811 (the Fund). A product disclosure statement (PDS) is available for the Fund and can be obtained by calling 1800 813 886 or visiting www.pentalgroup.com. You should obtain and consider the PDS before deciding whether to acquire, continue to hold or dispose of units in the Fund. An investment in the Fund is subject to investment risk, including possible delays in repayment of withdrawal proceeds and loss of income and principal invested. Past performance is not a reliable indicator of future performance.