Emerging Markets Outlook
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Growth Driving EM: Headwinds Abate
Global Fears: The U.S. dollar fully valued?

- The U.S. dollar has strengthened 39% since 2011; in prior periods of dollar strength (most of the early 1980s and in 1997-1998), emerging markets were in crisis, but not this time around.

Source BAML; HSBC. Data as of June 2017 (low chart) and March 2017 (upper chart). See disclosures on page 2.
Emerging markets equity have historically reacted favorably during U.S. rate hike cycles.
Global Fears: Populism and protectionism on the rise

- State aid is a key mechanism for trade discrimination
- Includes local procurement legislation, tax benefits for export and domestic industry subsidization, heightened regulatory standards, and public procurement discrimination
- Over the long haul, technology is a much bigger driver of trade than government policy
- Zero sum game – China steps into the vacuum

Source: Branko Milanovic (top chart), Merrill Lynch (bottom chart). Data as of December 31, 2016. See disclosures on page 2.
**EM Macro: Emerging markets have less financial vulnerabilities**

- Most emerging economies (with the exception of China) have floating currency exchange systems.
- Currency flexibility is a natural progression from mercantilism and gives central banks more control over monetary policy.
- Emerging economies are less vulnerable today due to major economic and financial reforms in the past decade.
- External and fiscal accounts have significantly improved from the “taper tantrum” period.

**Number of EM countries by exchange agreements**

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**Financial Vulnerability in EM**

- Equal-weighted average of financial vulnerability of GEMs markets (percent rank compared to history since Jan 1990), LS
- % of GEMs markets with high financial vulnerability (highest tertile), RS

Source: UBS (left chart) and Merrill Lynch (right chart). Right: Chart Data as of June of 2017. See disclosures on page 2.
EM Micro: EM companies’ earnings are exceeding expectations

- Often wrong, but never in doubt; 2017 a rare example of analyst EPS growth optimism coming true? BAML research suggests yes.

- EM 12m forward earnings estimates revisions accelerate

Source: BAML, HSBC. Data as of March 2017.
See disclosures on page 2.
**EM Micro: Capex declining and free cash flow galore**

- BAML predictions – all time high free cash flow in Asia ex-Japan

**Asia ex-Japan operating cash flow (US$ bn)**

**Asia ex-Japan capital expenditure (US$ bn)**

**Asia ex-Japan free cash flow (US$ bn)**

Source: CLSA. Data as of December 2016. See disclosures on page 2.
**EM Micro:** EM selling at a 90% discount compared to the U.S.

Source: Bloomberg, MSCI. Data as of June 2017. See disclosures on page 2.
Structural growth versus cyclical growth

Source: VanEck. Data as of December 31, 2014.
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