

“Dollar rise will not prevent EM from performing” says Gemway’s Vanier

InvestmentEurope has canvassed views of fund managers and selectors on emerging markets investment in light of the policies emerging from the Trump administration.

22 Février 2017

Bruno Vanier is the lead portfolio manager of the GemEquity fund at Gemway Assets, a Paris-based boutique he co-founded in 2012 with Michel Audeban and chaired since then.

The manager specialised on emerging markets is running travel notes summing up each trip made by the management team.

Surveyed on the countries which could be the most impacted by further measures and trade barriers implemented by the US, Vanier ranks Mexico number one as the country finds itself in a delicate position within the LatAm area given 80% of its exports are going to the US.

The manager adds that another country at risk remains China when looking at the American trade balance. However he does not worry for the country as its economy is getting ever more domestic.

Regarding LatAm investments, Vanier observes that the region is likely to return to growth in 2017 after years of recession.

“In Argentina as well as in Brazil, government reforms, commodity price rise, lower inflation and more accommodating monetary policies significantly improves the business environment. In Brazil for instance, interest rates are still 13% vs. an inflation below 7%. We estimate that they could cut by more than 300 bp even if US interest rates increase. In Argentina, they are still over 24%, which leaves plenty of room for the central bank to ease its policy should inflation declines.

“Same thing applies to Colombia. In Mexico, the situation is obviously different and monetary policy is much more dependent of the Fed. Inflation increases because of oil price and weak Peso. President Trump’s tweets fuel uncertainty by the day and domestic politics is not healthy. Taking these macro-economic data into account, we tend to focus more on Latin American markets such as Brazil and Argentina than on Mexico at this point of time. But there is no doubt that exciting opportunities will emerge in Mexico,” Vanier argues.

Mexico : Uncertainty around exports

Vanier notes that a weaker peso has increased Mexican industry competitiveness which de facto rises the peso value of overseas remittances (immigrants sending money home).

“These transfers (\$27bn in 2016, 2.8% of GDP) significantly boost consumption and are likely to remain high. Besides, Mexicans are not much indebted. We thus remain quite optimistic on staples consumption and concentrate our investment in this field,” he says.

Uncertainty dwells in exports towards the US but the lead manager of the GemEquity fund recalls that Mexico buys 26% of American exports and that Mexican exports towards the US “contain” 40% of imports from the US.

“We assume that Donald Trump is well aware of this matter. However, when taking all uncertainties into account, one remains cautious on the country short term outlook. The currency seems undoubtedly undervalued: -56% according to the Big Mac index from The Economist, but the stock market is still relatively expensive (around 16x earnings, ie. 10 year average). We would buy on weakness,” Vanier develops.

As of 31 January 2017, the GemEquity fund holds two Mexican stocks forming 2.2% of the portfolio against 3.5% for the MSCI Emerging Index. Some 0.71% of GemEquity net assets are invested in Unifin and 1.47% in Femsa.

What would mean a US withdrawal from regional trade deals? Again says Vanier the situation is more delicate in Mexico than in the rest of LatAm.

“Our local counterparts in Mexico are perplex regarding a possible renegotiation of Nafta and the future BAT (Border Adjustment Tax). The Peso, back to its 1995 level (Tequila crisis) reflects this uncertainty but the stock market is not cheap yet (back to its 10-year average). Taking into account the current uncertainties, forecasters expect a slowdown in 2017 and a hike in inflation (oil price adjustment, weak Peso).

“A lot of concerns are expressed regarding the possible renegotiation of Nafta and the introduction of a Border Adjustment Tax. Also sources of concerns are the low popularity of President Pena Nieto and the rise of Obrador, a populist politician (presidential elections in 2018). Same for the recent oil price increase (+23%) which has put many people in the streets of Mexico. The budget deficit, albeit showing a slight improvement, is still near 3% of GDP and the country could be downgraded by rating agency Moody’s,” Vanier explains.

China : crucial dollar/yuan relationship

The situation of China, one of the riskier countries in case of isolationism policy by the US in Vanier’s view, has led Gemway Assets’ team to spend a week in Beijing in January 2017.

“Most companies met are optimistic regarding their 2017 earnings potential. Even if the fiscal stimulus is likely to be lower this year relative to what it was in 2016, manufacturing PMI remains well above 50.

“Keqiang index has strongly rebounded and reflects a stronger nominal GDP. Industrial activity has rebounded in 2016 and margins are rising. This trend is confirmed by the Chinese PPI which is now well in positive territory (a result of not only the fiscal stimulus by the government but also by capacity cuts). Consumption remains strong, car sales rose 16% in 2016 and white goods also registered strong rise as well,” Vanier pinpoints.

The manager says the dollar/yuan relationship will be crucial, highlighting that the Chinese currency depreciated by 6.5% in 2016 and by 13% against the dollar since its highest level in early 2014.

“China lost near a trillion dollars in foreign reserves (from \$4 to \$3trn). This has weakened its position against the USA in future trade negotiations. More broadly, Dollar strength is deemed to be negative for emerging markets (outflows, risk reduction). While this has been true in the last 5 years, it has not always been the case,” argues Vanier.

The lead manager of GemEquity points out deteriorating fundamentals between 2011 and 2015 were the main reasons for capital outflows from emerging assets. He believes the current situation is different because of the positive stance towards earnings forecasts.

“In 2017, Russian and Brazilian economies are likely to return to positive territories. China GDP growth will be between 6.5% and 7%. India will recover from the demonetisation disruption. If all this is confirmed, we will be in a scenario similar to 2005 or 2010 and the possible dollar increase will not prevent emerging markets from performing.”

India : extremely positive on the long term

About India, Vanier estimates the demonetisation process that has started at the end of last year generates turmoil in the short term but will be extremely positive in the long term.

Gemway Assets’ chairman says it should seriously hinder corruption, black economy (estimated at 30% of GDP) and financing of terrorism from which India unfortunately suffers.

“In the short term, the turbulence generated by this measure might lead to an economic slowdown over the next 6 months, especially in real estate where most transactions are made in cash. The stock market reacted negatively (-8% on Sensex since 8 November 2016 and many stocks lost over 20%).

“In the medium term, only 3% of the cash in circulation has not been converted, which constitutes a limited exceptional earnings for the RBI (Indian Central Bank). Modi’s government could initiate a fiscal stimulus favoring infrastructure.

“In the long term, further financialisation should lead to higher bank deposits, which drives interest rates down, and to less black economy, which is likely to improve tax collection. It will also favor established companies and allow them to increase their market share from black unfair competitors. Modi’s bet is that these disruptions will not last long,” Vanier comments.

“They seem well accepted by the people who understand the long term objective. On the economic level, the demonetisation will cause in the short term growth slowdown, inflation decline and interest rates cut. In the longer term, structural growth of the country is likely to increase thanks to a better governance,” he adds.

Gemway Assets is therefore set to increase its Indian allocation and favour local leaders “of which long term outlook has never been so promising.”

Also Vanier terms the VAT (GST) reform to be implemented in April 2017 a proper revolution.

Russia : new cycle coming

Russia is part of GemEquity’s overweights (7.7% for GemEquity vs 4.5% for the MSCI emerging index as of 30 January 2017).

Vanier explains a new economic cycle is under way in the country, a cycle that appears sounder than the previous ones he says.

The recession that follows the oil price collapse and western sanctions after Crimea annexation is over and Russia’s recovery has been partially anticipated by the markets, he underlines.

Russian population is strong and resilient over time Vanier says, noting that Russian consumer is wealthier than 15 years ago and still consumes locally essentially.

“On the fiscal side, austerity is still applied. The ministry of finance elaborates its 2017 budget with an oil price at \$40/ bbl over 2017-2019. Obviously the western sanctions removal and the oil price rebound will help the local economy, but the current scenario (status quo of sanctions, barrel at \$40/bbl) is actually structurally positive.”

Vanier says this scenario favours the remodeling of Russian economy with higher emphasis on local production against oil dependency.

“As an example, Vladimir Evtushenkov’s investment consortium Sistema is now focusing on agriculture and pulp production. Following the ruble correction and given the cheap and educated workforce, Russia also becomes appealing as an export base to Europe for international players.

“Ikea is already exporting furniture that is manufactured locally. The major issue for foreign investors remains the governance: the country tracks poorly on property right protection for example,” according to the lead manager of GemEquity.

Eastern Europe : focus on Romania

Vanier assesses that Eastern Europe “seems to be back on track” after having been deeply affected by the financial crisis of 2008. The GemEquity fund remains underweight though (2.4% for GemEquity vs 5.6% for the MSCI emerging index as of 31 January 2017).

“Real and expected growth rates are satisfactory, fiscal deficits are under control, and almost every country achieved full employment. Inflation appears to be restrained despite wage growth and the catch up effect after many lean years. Let’s not forget that austerity plans and reforms in Central Europe such as the 30% wage cut in Romania in 2009 were brutal.

“Private investment is the only missing component. But as long as utilization rates are low and as visibility for global growth remains weak, private investment will be weak,” he says.

Within the Eastern Europe universe, Vanier picks Romania as the country to monitor closely this year.

“Following around 5% GDP growth in 2016, Romania will probably again generate the highest growth rate in the region in 2017 at about 4.5% expected. The country benefits from European funds for infrastructure which are boosting the economy thanks to the multiplier effect.

“In order to continue the wage and pensions catch up, the newly elected government will probably continue its expansionary fiscal policy. Nevertheless there is a risk of budgetary slippage (3% of GDP expected in 2017 and 3.8% in 2018) which could jeopardize the country credit rating,” Vanier says.

But he warns that in the event a Brexit would cause a decline in UK activity, Romanian migrant workers’ remittances could dry out as many of them work in construction or other low-wage sectors.

Source: <http://www.investmenteurope.net/regions/france/gemway-assets-dollar-rise-will-not-prevent-em-from-performing/>

Publié le 22 Février 2017, sur InvestmentEurope

