

# Divergences open up emerging markets opportunities

✓ **Rarely have emerging economies been subject to such powerful and conflicting forces. The result is a considerable dispersion in opportunities for investors**

**E**xceptionally powerful and competing economic forces are radically reshaping the landscape for emerging market (EM) investors. For those with analytical capabilities, the resulting divergence in country and asset performance makes this fertile ground from which to generate returns.

The global macroeconomic environment is exceptionally uncertain. On the one hand, the Covid-19 pandemic keeps delivering ugly surprises. On the other, global central bank liquidity remains generous, as do fiscal stimulus measures. Inflationary pressures are growing – some are temporary, others could well take hold.

All of which further muddies an already complicated picture – there is huge variation among EM economies. Spanning the full spectrum of economic activity, from raw commodities to finished high end manufactured goods, emerging nations are expanding at varying speeds. At the same time, there's significant differentiation in the assets on offer even within those countries.

In some cases, when a country's dollar-denominated bonds are richly-priced, it is its local currency bonds that offer the prospect of better attractive risk-adjusted returns.

In addition, the growing popularity of green bonds among sovereign issuers adds a further dimension to an investor's decision making.

Varying impacts of Covid, varying amounts of stimulus, big divergences in country fundamentals, the introduction of green bonds on top of locally and hard currency-denominated securities all make

navigating this EM bonds a challenge that demands expertise and experience.

## Covid

The single most important issue facing all countries, but particularly emerging economies given their relatively limited public sector and financial resources, is how hard they were hit by Covid-19 and how effective their responses have been.

Countries' relative performance, or their 'pandemic trajectory' is a key determinant of how their economies and markets are likely to shape up.

## Commodities

With the recovery has come a boom in commodities, not least oil. Though generally prices have pulled back from their highs amid signs of a Chinese slowdown, the overall trend has been positive this year. Some of this strength has been a result of rising demand as life gets back to normal.

## Social shifts

How emerging countries compare in terms of their performance on environmental, social and governance (ESG) matters is also bound to affect their investment appeal. Social and governance factors are particularly important in parts of Latin America, where leftist politics and populism are witnessing a resurgence. This raises the risk that these countries will suffer an erosion of their long-term creditworthiness as politicians attempt to spend their way out of problems, causing fiscal pressures to mount. At the same time, worsening youth unemployment, poverty and educational outcomes are

a threat to countries' human capital formation, with Latin America again particularly at risk.

## Monetary policy

Inflation is a big question for investors everywhere – but especially so in EM. Huge flows of global liquidity and substantial measures of fiscal policy have kick-started economies in the wake of the pandemic. Further waves of mass infection could yet prove a damper on both growth and price pressures. But as countries learn to cope with Covid, the existing stimulus could cause economic growth to boil over.

## Making the most of differentiation

Investors in emerging markets have their work cut out. Countries face more complex challenges than ever, many of them brought to the fore by the Covid pandemic. It has compounded the impact of differing degrees of development and differing access to resources, be they natural or man-made and ranging from infrastructure to human capital to strength of institutions. And it has added another dimension to domestic politics.

Pictet Asset Management has a multi-faceted investment approach, using expertise from across the firm, that weighs up macro, political, environmental and social dimensions. As a team, we have learned to pay greater attention to the risks and opportunities presented by environmental matters and transition risk.



✓ **Written by Pictet Asset Management head of emerging market debt, Mary-Therese Barton**

In association with



**PICTET**  
Asset Management