Back to school

September often brings a change in trading conditions as the market goes "back to school". With that, we thought it would be useful to take a step back and highlight a number of themes that we are focusing on to set the tone for the rest of the year.

News Analysis

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Whilst all of these themes have inherent risks, our central expectation is for the positive "tailwinds" for the emerging markets (EM) asset class to continue. Expect some pick up in volatility as the nights draw in, but a combination of high yields and improving fundamentals will continue to attract investors to the asset class.

Global

- **Continued stability for G3 monetary policy expectations**. We will gain an important insight at this week's Jackson Hole conference but overall we expect central banks to be extremely gradual and transparent as they withdraw accommodation. A solid, but unexciting growth backdrop and continued low inflation means there is no need for central banks to hurry. Gradual tightening will not be a surprise to investors, and as long as terminal rate projections remain low, the demand for yield will continue.

- **US fiscal policy/tax reform**. We think investors may now be excessively pessimistic, as surely the Republicans on Capitol Hill and in the White House can combine to at least deliver a tax cut. However, we don't expect anything that will lead to a meaningful recalibration of market based Federal Reserve rate hike expectations.

- **Geopolitics**. A significant wild card for investors. We have an ongoing flashpoint on the Korean peninsula and unresolved situations in Ukraine, Qatar, Syria and Venezuela. We also have in Trump, Xi, Modi, Putin, Erdogan, Mohammed bin Salman, Kim Jong un and Ali Khamenei a combination of the most overtly nationalist/populist leaders in charge of the world's largest military and geostrategic powers since at least the end of the Cold War. This is by definition a volatile cocktail. It is obviously hard to make high conviction predictions, although our base case is that for the rest of this year all of the aforementioned flashpoints continue to bubble away, but none either resolve themselves definitively or cause global risk aversion.

Emerging markets

- **China.** President Xi seems to be effectively consolidating power ahead of October's Party Congress. Our expectations of a new reform drive emerging from the plenum are low. Economic and financial stability are more important to the Party than, for instance, state-owned enterprise reform. For the rest of emerging markets, this is likely to mean that China will not be a source of volatility well into 2018, and we expect the Chinese economy will continue to grow above 6.5% year on year.

- **EM Growth.** We believe that the EM growth recovery, a notable feature of the first half of 2017, will continue. We expect stronger growth into 2018 in India and Brazil. After a long period of declining growth expectation in EM relative to the developed world, the gap is likely to widen again in favour of EM. This will give investors comfort that currencies are competitive and credit dynamics can stabilise.

- **Venezuela.** Our base case is that upcoming large October amortisation payments will be met, probably through a combination of Russian and Chinese support. We do not, however, expect this to lead to much demand for longer dated paper. The 'Cubanisation' of the country continues, and in the short term Maduro seems to have been effective in consolidating power.

- **Supply.** A somewhat more prosaic concern than those listed above, but we are mindful that new issuance in all credit markets will likely be increasing significantly in September.

- **Other countries.** Clearly there are a lot of individual country stories with the potential to create alpha opportunities. We would currently highlight continued disinflationary trends in South Africa, Turkey and Mexico and expectations of FX strength in India and Egypt. Argentina remains our most favoured overall story as we expect a more stable political backdrop to lead to a pick-up in growth expectations.